The Economist

NOVEMBER 30TH–DECEMBER 6TH 2002

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Politics this week

Nov 28th 2002
From The Economist print edition

The inspectors call

United Nations weapons inspectors arrived in **Iraq**, to search for weapons of mass destruction that Saddam Hussein, the Iraqi dictator, is thought to have hidden. Mr Hussein has until December 8th to give a full account of his arsenal. Failure to do so could trigger an American-led invasion.

See article: The inspections begin

In attacks on Israeli targets in **Kenya**, missiles narrowly missed an Israeli charter plane taking off from Mombasa airport and a car bomb destroyed a hotel where Israeli tourists are known to stay, killing at least 11 people. In northern **Israel** at least five people were reported killed when gunmen opened fire near a polling station.

EPA

See article: Thanksgiving terror

According to leaks, America is angry at **Saudi Arabia's** alleged reluctance to crack down on its own citizens who allegedly donate money to charities that serve as fronts for terrorists. American officials half-heartedly denied the reports. Relations between the two allies were strained.

Riots laid waste Kaduna, a Nigerian city of 1.5m, after a newspaper allegedly insulted the Prophet Muhammad. At least 220 people died and 11,000 lost their homes.

See article: Religious mayhem in Nigeria

A UN report revealed that 42m people are infected with HIV, the virus that causes **AIDS.** This year, 3.1m died of the disease, and 5m were newly infected. The cumulative toll of deaths and infections now exceeds the number who died in the second world war.

See article: AIDS in Africa

In a state

A survey found that **America's states** must take drastic action to keep their budgets balanced, as constitutionally required. Unexpectedly low tax revenues and large spending plans caused states' revenues to fall last year in absolute terms, for the first time since 1945. Tax rises and cutbacks are now expected.

See article: Fiscal problems at state level

White House officials said that President George Bush is planning **smallpox vaccinations** for 500,000 troops and 510,000 civilian health workers within a week. Vaccinations for the rest of America could follow in the new year.

See article: Global preparations for a smallpox attack

Mr Bush signed two **anti-terrorist bills** into law; the first created the new Department of Homeland

Security; the second made the government the insurer of last resort in the event of another large attack. Mr Bush claimed that it would be a big boost for the economy. The president also appointed Henry Kissinger to lead an independent commission to investigate the attacks on September 11th. Critics wondered whether the former secretary of state would be independent enough.

See article: Preparing for terror

Dockers and shippers at ports on America's west coast finally reached a deal. New technology will be introduced, but the dockers will be in control of it—and they get a pay rise.

See article: Port strike settled

NATO expands eastwards

EPA

At a summit of the leaders of **NATO's** 19 countries in Prague, seven countries from Eastern Europe were invited to start negotiations to join the alliance, with a view to becoming members in 2004: Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia and Slovenia. Leaders of the existing members approved the idea of a new NATO reaction force and promised "effective action" to deal with Iraq.

Reuters

Austria's mainstream conservatives, the People's Party, led by the incumbent chancellor, Wolfgang Schüssel, won first place in a general election for the first time in 36 years, gaining 42% of votes cast, while its partner in the previous coalition, Jörg Haider's far-right Freedom Party, slumped from 27% at the last election to 10% this time. The Social Democrats' tally rose from 33% to 37%. It was unclear what government coalition would emerge.

See article: The revival of Austria's mainstream right

A **French** autumn of discontent loomed, as French lorry-drivers went on strike for more pay, as usual blocking the roads; an array of other public-sector workers took to the streets and threatened to strike too.

See article: Can France's trade-unions be outmanoeuvred?

A proposal put to referendum in **Switzerland** to curb illegal immigration more strictly was rejected by a whisker—provided that a recount in one canton does not tip the balance.

See article: The Swiss divided over asylum-seekers

Tigers talk

The leader of Sri Lanka's **Tamil Tigers**, Velupillai Prabhakaran, confirmed that he was prepared to abandon his demand for a separate state for Tamils and settle for regional self-rule. Talks between the Tigers and the Sri Lankan government are continuing, brokered by Norway.

A report in the *New York Times* quoted American intelligence source claims that Pakistan has helped **North Korea** with its nuclear-weapons programme in return for missile technology. Pakistan's new civilian government denied the report.

Australia, normally a grains exporter, started importing wheat and corn to meet a shortage resulting from a widespread drought.

Twenty people died in attacks in Indian-run **Kashmir**, two of them on Hindu temples. India blamed

Pakistan-trained militants.

See article: Violence in Kashmir

Eurico Guterres, leader of the pro-Indonesian militias that ravaged **East Timor** in 1999, was convicted in an Indonesian court of crimes against humanity.

Ecuador's new boss

AP

Lucio Gutierrez, a retired army colonel, became **Ecuador's** new president after winning a run-off election with Indian and union support. Confounding his political allies, Mr Gutierrez immediately said that he would seek a new loan from the IMF.

See article: Lucio Gutierrez takes charge in Ecuador

Election authorities in **Venezuela** agreed to hold a non-binding referendum in February on whether the flailing populist president, Hugo Chavez, should resign. The referendum had been demanded by the opposition, which had collected 2m signatures demanding the vote.

Haiti was shaken by big demonstrations against the regime of President Jean-Bertrand Aristide, to which the government responded with counter-demonstrations by its own supporters.

See article: The situation worsens sharply in Haiti

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Business this week

Nov 28th 2002
From The Economist print edition

Share and share alike

GlaxoSmithKline's shareholders reacted with undisguised hostility to a planned pay package for Jean-Pierre Garnier, the drug company's chief executive. GSK was forced to back away from a deal worth up to $18m, according to the company, or $27m according to outsiders.

See article: GSK's pay debacle

Disgruntled shareholders won another victory at **Cable & Wireless**. Two years of bad investments and a plunging share price moved investors to demand a management shake-up. The first victim: David Nash, chairman-in-waiting. The main target now: Graham Wallace, chief executive (for the moment).

Mechanics at **United Airlines** rejected a pay cut that managers had proposed as part of a recovery plan. Pilots and flight attendants had earlier accepted pay cuts. The airline now looks unlikely to secure a government guarantee for further loans; so it will almost certainly go into Chapter 11 bankruptcy instead.

See article: United Airlines on the brink of bankruptcy

US Airways attempted to secure a federal-loan guarantee that will allow it to emerge from Chapter 11 next year. It will lay off some 7% of its workforce—around 2,500 employees—to save $400m a year.

Energising Europe

France has agreed to **liberalised energy markets**. An EU-wide agreement will allow all retail customers to choose their supplier by 2007 (businesses will have that opportunity by 2004). France had led opposition to liberalisation; it may still seek to protect the interests of its national champion, Electricité de France.

See article: Energy in Europe

Eni offered *euro*2.5 billion ($2.5 billion) for the 56% that it does not already own of **Italgas**, Italy's largest gas distributor, to take advantage of liberalisation. Italgas has interests in Portugal and Eastern Europe; its shares jumped.

Pressure from government and trade unions forced **Fiat Auto** to scale back plans for huge lay-offs. The government may demand more concessions from the ailing car firm, at a time when what it really needs is drastic restructuring.

In the money

Vivendi Universal revealed losses in the third quarter had widened compared with a year ago, to *euro*1.2 billion ($1.2 billion) but it insisted that its recent cash crisis was over after asset sales—most recently half its stake in Vivendi Environnement—and fresh refinancing agreements. Vivendi is set for a battle with Vodafone for control of Cegetel, a cash-generating French telecoms firm.

The French government is to inject *euro*9 billion ($9 billion) into **France Telecom.** The move is designed

to reduce the group's indebtedness as the government prepares to transfer its 54.5% stake to a separate publicly owned body.

WorldCom settled a case brought by the SEC, which had accused it of inflating profits by $9 billion. It promised not to do it again, to submit to independent scrutiny and to give some staff re-education in corporate good behaviour.

See article: The anniversary of a shocking bankruptcy

Bertelsmann, the German media giant, decided on a price of $2.7 billion for Zomba, the world's biggest independent music firm. Zomba's owner exercised an option to sell in June.

Taking the credit

The French government arranged a quick-fire auction of its 10.9% stake in **Crédit Lyonnais** after Crédit Agricole refused to pay what the government wanted. BNP Paribas paid a hefty *euro*2.2 billion ($2.2 billion) for the stake, at an unusually rapid weekend auction. Crédit Lyonnais's shares soared on the prospect of a bidding war to win control of the bank.

See article: French banking

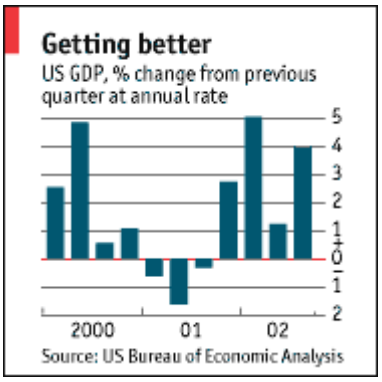
Credit Suisse, ING of the Netherlands and Spain's largest bank, **Santander Central Hispano**, all announced measures to raise cash in an attempt to shore up their dwindling capital bases.

Manufacturing freedom

America strengthened its **free-trade** credentials, by calling for all tariffs on manufactured goods to be abolished by 2015 and deep liberalisation of trade in service industries. The bold measure is likely to meet opposition from high-tariff developing countries.

See article: Can America kickstart the Doha round?

America's economy appeared to be on the mend. Third-quarter GDP growth was revised sharply upward from 3.1% at an annual rate, to 4%. However, evidence suggests that heavy government spending and zero-interest car sales had made a strong but unsustainable contribution.



The prospect of government intervention forced **Japan's largest banks** to unveil plans to tackle bad debts: cost-cutting, loan write-offs, cancelled dividends and reduced pension payouts. This may not be enough to satisfy the finance ministry, which is set to publish its own plan to counter the problem, backed by the threat of nationalisation.

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Terrorism

Preparing for terror

Nov 28th 2002
From The Economist print edition

How scared should you be?

Get article background

NOBODY can accuse George Bush of a want of energy in his response to the challenge of September 11th. Over the past 14 months, he has shown himself willing to change the map of the world, if that is what it takes to keep Americans safe. He toppled the regime that gave al-Qaeda its Afghan sanctuary. He is poised to remove Saddam Hussein if Iraq does not convincingly renounce weapons of mass destruction. He has rewritten America's security doctrine around the notion of pre-emption, so that he can "confront the worst threats before they emerge". And this week Mr Bush signed a bill that creates a new Department of Homeland Security, heralding a vast federal reorganisation.

Given this activism abroad and (apparent) radicalism at home, you may be tempted to feel more relaxed about the danger of terrorism. Don't be. America and its allies have notched up some successes against those who planned the felling of the twin towers. But "forward defence"—striking al-Qaeda and its offshoots in distant lands, closing down its foreign sanctuaries, intimidating its sponsors and lopping off its paymasters—can be only one part of this prolonged war. The other consists of preparing the home front for the fresh terrorist blows that many intelligence services now say are not merely inevitable but imminent. October's atrocity in Bali, plus strong evidence this month that Mr bin Laden is still alive, promising now to add Australia, Canada, Italy, France, Germany, Russia and Britain to his list of targets, underlines the need to harden defences at home—ie, at all those homes.

Still wide open to attack

No American, though, should derive great comfort from the new Department of Homeland Security. It is to be created for the most part by a grand reshuffle of existing departments and agencies. This means that hoped-for gains in efficiency will be offset by the energy-consuming and attention-distracting losses that large federal upheavals entail. And some of the agencies—notably the CIA and FBI—whose failures contributed to the success of the attacks of September 11th, are not touched at all. At some point, alien as this is to its liberal political culture, the United States will have to consider creating a domestic intelligence agency on the lines of Britain's MI5.

However, the main reason not to be reassured by the new department has little to do with the merits of its organisational chart, or with the things it leaves out. It is simply the formidable magnitude of the terrorist threat that seems now to loom over all free, open and complex democracies. Tom Ridge, the new department's boss, is creditably honest about this. He acknowledges that diverse and mobile societies, where people congregate in large numbers in public spaces, linked by vulnerable production systems and supply chains to the essentials of life, are exquisitely vulnerable to catastrophic attacks.

The home front is never going to be glamorous. Yet it entails risks and trade-offs no less delicate than in farther-flung wars. If the puzzle abroad is how America and its allies can strike at the terrorists in a way that avoids turning new hearts, minds and governments needlessly against them, the puzzle at home is how rich and open societies should brace against terrorism without at the same time inflicting needless damage on their ability to remain rich and open.

Understandably, much of the commentary since the felling of the twin towers has focused on whether the balance between public safety and civil liberty needs to be recalibrated; and, if so, where the new balance should be set. But this is only a sub-set of a broader question, which is how lethal, and how new, the danger from so-called “super-terrorism” really is. It is, quite simply, impossible to know for certain.

How big a change?

In Europe especially, one response is to advocate a robust fatalism. America, on this view, is over-reacting: the September 11th attack was different in scale but not in kind from earlier episodes of terrorism. For all the trauma, the 3,000 deaths on September 11th did not exceed the fatalities in 30 years of British “troubles” in Northern Ireland and were tiny compared with the toll from crime, disease, natural disaster and the rest. Does this really justify reordering a society's priorities?

The case for thinking it does is that al-Qaeda's terrorism is different in kind from the sort practised by traditional terrorists. Well before September 11th, expert opinion started to worry that terrorists would turn to chemical, biological, radiological or nuclear weapons, and so threaten millions of victims, not just hundreds or thousands. In the late 1990s a succession of warnings were sounded that this would soon become America's chief security threat. The warnings were ignored, not only because the cost of fending off such threats looked prohibitive, but also because of a lingering calculation that even terrorists were rational, deterrable political actors, with a strong interest in keeping their violent actions within some limits if they were to achieve their political ends.

In Europe, which has yet to suffer a large-scale al-Qaeda attack, governments risk being made complacent by their long experience of a different sort of terror

Everything that is known now about al-Qaeda indicates that it does not fit this template. Its aims are mystical, not rational. It does its violence in the name of Allah and so accepts no worldly obligation to moderate it. It is rich, and it is capable. Mr bin Laden and his men have made it plain that they are out to inflict maximum punishment on the infidel nations, and that they want unconventional weapons.

It is surely right, given the emergence of such a threat, to turn previous assumptions about terrorism and public safety upside down. Measures that seemed prohibitively expensive in the late 1990s now look merely prudent. No country that considers itself a target can escape the need to make sure that its hospitals are geared up to identify a biological attack (see article), or that it knows how to clean up after a radiological one. America now takes this for granted. In Europe, which has yet to suffer a large-scale al-Qaeda attack, governments risk being made complacent by their long experience of what was a different sort of terror.

Thanks to the nationwide trauma of the twin towers, but also to the more open nature of their politics, Americans have put the large but unquantifiable risk of catastrophic terrorism plumb at the centre of their domestic political debate. Most Europeans have not. In Britain, it is next to impossible to discover what changes, if any, the government has made to its defence plans. Americans are caught in a blizzard of hard-to-evaluate warnings; Britons, having received virtually none, are victims of an old culture that says Whitehall knows best.

But Whitehall cannot know best. Secrecy and centralisation are useful watchwords in a conventional war. In this shadowy new one, it is citizens who are going to have to calculate the odds, both individually, as they decide what risks to run in the quotidian decisions of life—whether to take the bus or tube, say—and collectively, as they decide how much a society should be willing to sacrifice in order to secure itself against new dangers. Nobody should sow panic. But if the war against terrorism is going to last for years, governments need to mobilise their people. The way to do that is to treat them as adults and give them as much information as possible without compromising sources of intelligence—even if this does cause a few sleepless nights.

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About sponsorship

Enron a year on

Investor self-protection

Nov 28th 2002
From The Economist print edition

The biggest lesson from Enron is that investors must look after themselves

Get article background

A YEAR has passed since the dramatic implosion of Enron, once America's seventh-biggest company. A swashbuckling, self-proclaimed disciple of the “new economy”, the Texan energy-trading giant had set itself the brash goal of becoming the world's biggest company. Instead, in December last year, it became America's biggest-ever bankruptcy, shocking workers, investors, regulators and even congressmen (three-quarters of whom had taken Enron campaign contributions).

Worse, Enron was followed by a seemingly unstoppable surge of revelations about corporate sleaze and audit fraud that engulfed WorldCom, Global Crossing, Tyco, Adelphia and others—and even put out of business one of the world's oldest accounting firms, Arthur Andersen (see article). The drip-feed effect has been devastating for investors' confidence, helping to prolong the longest and deepest bear market since the second world war. And it has cast a shadow over the economy: Enronitis has been a big contributor to the past year's economic ills in America and the rest of the world.

Not surprisingly, people now crave reassurance that everything possible has been done to punish corporate wrongdoers and to stop any repetition. Politicians and regulators have fallen over themselves to provide it, even if surprisingly few prosecutions have actually been brought so far. In July President Bush, no less, promised to end the days of “cooking the books, shading the truth and breaking our laws.” And Congress passed a hastily written law, the Sarbanes-Oxley act.

Has this been enough to make investors safer? There are two answers. One is that more should still be done, notably on implementation. The need is not for more laws and regulations. Indeed, the danger after Sarbanes-Oxley is that there may be too many new rules not too few, increasing the risk that audit and corporate governance turn into meaningless box-ticking exercises that afford investors no extra protection.

Where further action is most wanted is in auditing. After the Republican triumph in the congressional elections, the Bush administration may consider that it can go more slowly on corporate reform. Yet the new board set up by Sarbanes-Oxley to regulate auditors remains leaderless, after the resignation of William Webster as its putative first chairman; so does the Securities and Exchange Commission after the departure of Harvey Pitt. If it wants to regain confidence, the administration must fill both jobs, with well-qualified heavy-hitters, as a matter of urgency.

American companies should adopt the common European practice of separating the jobs of chairman and chief executive

Accounting standards, too, need attention. Here the news is more encouraging. America's Financial Accounting Standards Board, which for years insisted on sticking to its generally accepted accounting principles (GAAP) system, has declared a willingness to converge towards international standards. That could bring closer a harmonisation of accounting practices around the world. With luck, it could also push American auditors in the direction of principles-based accounting rather than GAAP's overly complex (and too easily bent) rules.

The basic check, though, is corporate governance. Some of the Sarbanes-Oxley rules for bosses and directors may be too cumbersome or prescriptive: requiring chief executives and finance officers to sign their accounts is good theatre, but it is not likely to help investors much. A more useful idea is a toughening of checks and balances for bosses. Best of all, American companies should adopt the common European practice of separating the jobs of chairman and chief executive, entrenching a check at the heart of their corporate-governance systems.

The joys of market discipline

There is, however, a second answer to the question of whether investors are now any safer. It is that they may be, but thanks to a more powerful force than any rules or regulations: the self-correcting discipline of the marketplace. Bosses will always be greedy, auditors will always be fallible, boards will always miss things; but the post-Enron climate has made these mistakes less likely, at least for now. Auditors are being more thorough, and audit fees are rising. Public outrage over bosses' remuneration has led to change: General Electric is charging its ex-boss, Jack Welch, for benefits that it had agreed to give him free, and this week GlaxoSmithKline's board dropped plans for a huge hike in its chief executive's pay (see article).

None of which is to suggest that investors can now rest easy. The bursting of the stockmarket bubble showed that their pursuit of safe, double-digit real returns was illusory; Enronitis showed that there is no substitute for constant scrutiny and questioning. In the end, if investors are ready to suspend disbelief when confronted by companies with inflated numbers and implausible business plans, no amount of regulation can save them. For prudent investors, the price of the marketplace has to be eternal vigilance.

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Hong Kong

The gadfly stands aside

Nov 28th 2002
From The Economist print edition

Hong Kong needs people with the annoying qualities of Martin Lee

AP

Get article background

IT TAKES an unusual set of qualities to make yourself a monumental pain in the posterior to both the colonial British and the communist Chinese, and to keep on doing so for more than two decades. It takes moral and even a degree of physical courage, and a readiness to pass up the honours and rewards that others are happy to accept. It takes a dogged dedication to detail, often pushing an audience well beyond the point of tedium. Most of all, though, it takes a belief bordering on naivety that laws matter and that promises ought to be kept, plus a Cassandra-ish notion that one must prepare for the worst while others hope for the best. Those, more or less, are the qualities that Martin Lee, Hong Kong's most prominent liberal politician, has brought to his long but not very successful struggle to secure democracy for his home territory.

Mr Lee, a Hong Kong QC whom officials there and in Beijing must often wish would stick to the commercial bar, is retiring on December 1st as leader of the party he founded. The Democratic Party wins more votes than any other group in Hong Kong's legislature, Legco, but because of the democracy-twisting rules that obtain there, whereby only 24 of the 60 seats are filled by direct election, their chance to influence policy is limited. Thirty of the seats are filled from within “functional constituencies”, such as business groups and trade unions, a system bound to produce complaisance. The other six members are chosen by the same electoral college that, earlier this year, returned Tung Chee-hwa as Hong Kong's chief executive for a second five-year term, unopposed. This rotten system is up for review, except that no one has yet explained when the review will be conducted, or how. The outcome, however, is not in much doubt: minimal change, if any.

So perhaps it is with a degree of relief that Mr Lee is stepping back from the front line. But he will remain a member of Legco and, he promises, will go on travelling the world to protest at the erosion of political rights in Hong Kong. His latest crusade is against the Hong Kong government's decision to enact new legislation which will make it a crime to attempt to “subvert” the Chinese central government, which places new restrictions on the press, and which gives the Hong Kong government the authority to ban political organisations (like the Falun Gong cult) on the say-so of the government in Beijing.

It is true that the Hong Kong government was under an obligation to produce some form of anti-subversion law under the terms of Hong Kong's mini-constitution, the Basic Law. It is also plausibly argued that the government has tried hard to set as high a threshold as possible before the new laws apply. But the fact remains that the proposals mark a step in an unwelcome direction, and included some unexpected nasties. It is largely thanks to Mr Lee and his colleagues that there is any pressure at all on the Chinese and Hong Kong governments to modify them. Long may he continue to annoy.

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Britain's public finances

The bill to come

Nov 28th 2002
From The Economist print edition

Gordon Brown's short-term deficit is fine, but his long-term plans look much more problematic

AP

SINCE Gordon Brown took office in 1997, he has always occupied the fiscal high ground. Budget deficits were history. Surpluses became standard. This budgetary strength was a source of political confidence. Before last year's general election, it allowed the government to announce a massive three-year boost to public spending until spring 2004 intended to improve the public services; and yet to have sufficient cash in reserve not just to quell the fuel tax revolt but also to buy off disgruntled pensioners.

But in this week's “pre-budget report”—a sort-of mini budget or early warning of the next—Mr Brown was on the defensive. For one thing, he had to deliver his speech in the midst of the most dangerous industrial unrest since Labour came to power. The firemen's strike imperils not just lives but—if it leads to public spending increases disappearing into pay packets rather than generating improvements in services—the government's entire strategy for its second term.

At the same time, the chancellor now finds himself on dodgy fiscal ground. The surpluses have vanished and the swing to deficit is much bigger than was planned in the April budget. The Treasury now forecasts borrowing of £20 billion ($31 billion) in the financial year ending March 2003 and £24 billion in 2003-04, up from its budget forecasts of £11 billion and £13 billion.

The chancellor was ready with his excuses. He blamed—as chancellors in trouble tend to—the world economy. But he was making no apologies for resorting to borrowing. He argued that the ability to increase borrowing when the economy hits a rough patch was a tribute to the robustness of the fiscal framework he has established. Unlike beleaguered euro-area finance ministers who are subject to the rigid constraints of the stability pact, Mr Brown's fiscal rules take account of the state of the economic cycle, so that he can borrow more freely when the economy is weak. By doing so, he helps boost demand—one reason why Britain has fared better in the global slowdown than has the euro area.

Mr Brown has a point: there is no need to panic at this stage about a run of deficits this year and next. The government has the lowest ratio of debt to GDP among the G7 club of rich industrialised countries. And Mr Brown can borrow freely now and still meet his own rule of borrowing only to invest over the cycle, precisely because of past surpluses. Even for those who are inclined to panic, it would be the wrong response. With the world recovery faltering, the last thing the British economy needs next year is for fiscal policy to be tightened.

Don't bank on a blip

But if Mr Brown's plans look fine in the short term, the long term is a different matter. The scale of the deterioration in the public finances suggests that the shortfall is more structural than cyclical. What seems to have happened is that tax revenues were temporarily swollen in the late 1990s by a boom in both the profits of the financial-services industry and the number of rich people. The Treasury built those higher revenues into its forecasts, but they have turned out to be a blip, which leaves a hole in Mr Brown's sums.

Any chancellor can miscalculate tax revenues: the margin of error in forecasting public borrowing a year

ahead is £10 billion. But what has made the mistake more serious for Mr Brown is that he has made such firm and extensive spending commitments. In July, he rolled forward his three-year expenditure plans to 2005-06, announcing a further huge increase of over £60 billion in departmental budgets; for the NHS his commitments stretch out to 2007-08. Here, there was no miscalculation at all from a political perspective: Mr Brown wants a bigger state to deliver better public services.

Such sharp growth in spending would be a bad idea at the best of times. Rather than increasing government outlays on public services quite so fast, Mr Brown should be thinking about how to bring more private money in. And these are not the best of times. The inevitable consequence of Mr Brown's determination to stick to his spending plans, combined with disappointing tax revenues, will be a rise in taxes—and a nasty feeling that Britain has been down this road before.

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The state and the arts

Patrimony and privatisation

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Europe's cultural chieftains must overcome their fear of the private sector

PRIVATISATION is a dirty word for those in charge of Europe's cultural institutions. Earlier this year the then French minister of culture, Catherine Tasca, and Henri Loyrette, head of the Louvre, engaged in a spat in the pages of *Le Monde* over the management of France's biggest museum. It culminated in Ms Tasca accusing Mr Loyrette of demanding ever more autonomy from the state and of even flirting with, shock horror, the idea of privatising the Louvre.

Plans by the Italian government to privatise part of the country's cultural heritage have caused even more indignation among the great and the good. Silvio Berlusconi and his ministers are accused of being little better than the Taliban when they destroyed priceless buddhas. The government is plotting to sell the Colosseum, it was claimed, which might be used to stage a sequel to “Gladiator”. Italy, the critics averred, was in danger of becoming a Disneyland of western culture.

In an ideal world for cultural purists, a country's heritage should be untouched by commercial considerations (ie, the demands of the public). Museums would have lots of public money, sufficient space to expose most of their treasures and enough staff to look after them. Museum managers could focus solely on complementing collections by new acquisitions and on hiring the most expert curators. All of this would be generously financed by taxpayers—and nobody would need to ask them what they thought or wanted.

In reality, Europe's cultural institutions are being belatedly forced to swallow their pride and think about such vulgar concepts as profits and customers. Many are in dire financial straits, as cash-strapped governments cut subsidies. The Louvre, once fully funded by the state, today gets only 70% of its $110m annual budget. This year Mr Loyrette has had to cut his conservation budget by a quarter, cancel exhibitions and shut 26% of his galleries due to a lack of staff. The Uffizi in Florence is so broke it cannot pay its electricity bill.

European museums have managed pitifully badly when it comes to finding alternative sources of cash. Their shops are often poorly stocked, their fund-raising teams small and inexperienced. Most still shy away from naming parts of their buildings after generous benefactors. And state interference remains heavy-handed. Although Jean-Jacques Aillagon, France's new culture minister, has come out in favour of a plan for more independence for national museums, he insisted that this was not about privatisation, but responsibility.

Italy's government has come up with a bold plan to ease the cultural establishments' cash crisis by setting up a new state agency to manage and market Italy's cultural treasures (see article). Patrimonio dello Stato will not privatise museums or sell important archaeological sites. It will, however, let private companies manage the daily operations of museums for a limited period, securitise the entrance fees for certain cultural sites (without allowing majority ownership) and sell relatively minor landmarks. “The Italian state simply doesn't have sufficient resources to manage its cultural patrimony,” says Giuliano Urbani, the minister for culture.

All European governments will eventually have to follow suit, by entering into some form of partnership with the private sector to run their museums. Regulated and supervised properly, this might even raise standards, for instance by improving educational activities or the use of audio-visual technology. Most of

America's cultural institutions are privately run and get little cash from, or interference by, the federal government. Despite (or because of) this, they still manage to be among the best in the world. European museums should not be shy to seek freedom of their own. It will be Europe's loss if its hallowed museum halls remain partly shut and badly run, all because they are unable to let go of their nanny.

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Letters

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From The Economist print edition

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Feeling deflated

SIR – Government subsidies and an interest rate of zero that keep inefficient firms afloat are cited as part of the reason for Japan's debt-deflation ("Comparing symptoms", November 9th). In theory, American firms are under greater market discipline. In reality, airlines, agriculture and steel are subsidised; low interest rates are keeping America's car industry alive; and generous Chapter 11 bankruptcy protection ensures continued overcapacity in IT and telecoms. Companies need to give consumers time to regain their appetite. Forcing consumers to gorge on low prices and special deals puts off the restructuring that many firms need. Rather than stimulating demand, this may contribute to the deflationary danger.

Moreover, Wall Street's banks may be less exposed to bad debt than Japan's banks but many big names are carrying huge derivatives exposures. A further drop in confidence coupled with a dip in consumer spending could having damaging knock-on effects in the financial markets.

Adam Hamdy
Willoughbridge, Shropshire

SIR – As someone who will soon retire to live on a fixed income, deflation sounds delightful to me.

Hilary Barnes
Sonzay, France

Gun law

SIR – Your article about water politics and the legal muddle through which the Pecos river is now flowing fails to note improvements in the administration of justice in that region since the frontier days of the early 20th century—albeit at the loss of local colour ("A lawsuit runs through it", November 16th). Judge Roy Bean, known as "the law west of the Pecos", came up with a famous definition after a defence lawyer challenged the court's jurisdiction. Bean, who always wore two sidearms when he sat on the bench, took both pistols out of their holsters and emphatically placed them on his desk. "Is that enough jurisdiction for you, counsellor?" he asked.

Harvey Leve
Bali, Indonesia

Remodelling Cyprus

SIR – You repeat the UN's claim that its draft agreement for Cyprus is based on the Swiss model ("Hold your breath", November 16th). As a native of Switzerland, I can attest that it is not made up of two separate entities, each with its own government, language, citizenship, police and court system.

As a resident of Bosnia & Hercegovina, I am aware that such a system cannot work without a central authority holding it together. It is only now, seven years after the signing of the Dayton agreement, that the central state is beginning to function, thanks mostly to the robust interventionism of the international "high representative". That no such office is foreseen under the Cyprus plan bodes ill for the intricate special regimes that are proposed to settle property disputes, the return of displaced people and similar

thorny issues.

The most disturbing provision will let the component states—now mostly “ethnically pure”—restrict residence of citizens of the other entity to 1% in the first year, rising by 3% in every subsequent three-year period. Surely the people of Cyprus deserve a more workable solution?

T.K. Vogel
Sarajevo

A welcome for Turkey

SIR – Statements such as the ones made by Valéry Giscard d'Estaing and Elmar Brok against full EU membership for Turkey reveal a short-sighted view of Europe (Charlemagne, November 16th). European identity must not be based on ethnic or religious elements, but on universal values such as democracy, human rights, civil liberties, pluralism, rule of law and a market economy. Turkey is entitled to be treated as any other candidate country was in the past. The historical opportunity for an Islamic society to become truly open should not be missed given the extraordinary effect the example could have on the rest of the Islamic world.

Alejo Vidal-Quadras, MEP
Vice-president of the European Parliament
Madrid

Close the family business

SIR – As a shareholder with a vested interest in the franchise, I find your recommendations for reforming the House of Windsor fascinating (“Rebrand or bust”, November 16th). However, the parlous state of the business and lack of any meaningful analysis on its profitability leads to one conclusion: the rot goes so deep that only a members' voluntary winding-up would make economic sense.

The brands could be sold for a peppercorn to media moguls willing to pay for repackaging. The fixed assets could be used in the relaunch of a leaner more profitable outfit with a chief executive subject to quadrennial re-election and a two-term limit. This would return Britain to its core business and give the family partnership freedom to develop its brands in the entertainment industry, where it belongs.

Paul Turner
Hong Kong

Specialist education

SIR – Your article on specialist schools incorrectly describes their additional five value-added points in the proportion of pupils who achieved at least five good grades at GCSE, compared with that achieved by other non-specialist schools, as a difference of just 5% (“Not very special”, October 5th). In fact, the difference was five percentage points, or 11%. This compares well with a modest 4% in extra funding that specialist schools receive.

Also, you do not point out that the longer a school has been specialist the better it performs. The first group, designated in 1994, achieved a remarkable 66% of pupils getting five or more A*-C grades at GCSE this year compared with only 40% in 1994. All other comprehensive schools improved from 36% to 45% between 1994 and 2001.

Sir Cyril Taylor
Technology Colleges Trust
London

Who pushed Bush?

SIR – You report that Colin Powell successfully convinced George Bush to shift his policy on Iraq from a unilateral to a multilateral approach (“The quiet man's moment”, November 16th). Nothing could be farther from the truth. Mr Bush, Dick Cheney, Donald Rumsfeld and Condoleezza Rice spoke of nothing but unilateralism until polls began to show that most Americans favoured action within a coalition. The elections, rather than reason and logic, influenced policy. And Karl Rove—not Mr Powell—deserves credit

for the change of heart.

Daniel Smith
San Jose, California

SIR – Mr Powell got his way with Mr Bush's Iraq policy but there was another statesman with similar influence: Tony Blair.

Bernard Del Bello
Garden City, New York

e-mail

SIR – Can we safely assume that you are prepared to add an “e” to your “By George!” cover in two years' time (November 9th)?

Edgar Edwards
Austin, Texas

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Biological terrorism

The spores of war

Nov 28th 2002 | SAN FRANCISCO
From The Economist print edition

The world has only just woken up to the threat of bioterrorism. And only America has yet done much to prepare for it

SIX days before the terrorist attacks of September 11th last year, Joseph Biden of Delaware told Senate hearings that the threat of biological attack on America dwarfed the dangers posed by missiles. Shortly afterwards, his colleagues Thomas Daschle and Patrick Leahy, along with various journalists, were the targets of just such an attack, when letters containing anthrax spores were delivered to their offices through the ordinary post. Five people died after exposure to spores that had leaked from the envelopes, scores more were infected, and strong antibiotics were pumped into thousands who might have been exposed.

Biological weapons—whether the sophisticated products of a national military programme, or the crude poisons of a biological Unabomber—sit at the lower end of a spectrum of biological threats to health. At the higher end sit naturally occurring epidemics of familiar diseases such as influenza, which still sweeps the world each year, and AIDS, which has so far killed 22m people. In between lie re-emerging and previously unidentified diseases, such as ebola or West Nile virus; industrial accidents or sabotage, by which bugs get out of laboratories; and growing resistance to antibiotics. On November 12th, a hospital in Detroit reported the first American case of staphylococcus (a potentially deadly infection) that is resistant to vancomycin, the strongest antibiotic in doctors' arsenals.

Compared with all these, biological weapons are a much more unlikely danger. Nor are they always simple to use. Aum Shinrikyo, a Japanese cult that carried out an attack with sarin nerve-gas on the Tokyo underground in 1995, had earlier experimented with anthrax, to little effect. The anthrax spores sent through the mail in America were a much more virulent strain and were finely milled, making it easier for them to penetrate the lungs of their victims. Prevailing weather conditions, such as wind speed, can interfere with the most diabolical planning.

Nonetheless, bioweapons have a fearful potential that has long been understood, ever since plague-ridden corpses were catapulted into the besieged city of Caffa by Tartars in 1346. Modern biological agents are far more lethal than even the most toxic chemical agents. In the 20th century most of the large military powers developed biological weapons, but moral repugnance and doubts about their military value largely kept countries from using them against each other.

This reluctance was formalised in the Geneva Protocol of 1925 and a Biological Weapons Convention signed in 1975, after America had renounced its programme, but as many as 17 countries are thought to have kept up some sort of capability. Troublingly, all seven countries on America's list of states that sponsor terrorism—Cuba, Iran, Iraq, Libya, North Korea, Sudan and Syria—are among the suspected dabblers. So far, none of the regimes thought to possess them is known to have passed on bioweapons

to a terrorist group, though no one really knows.

When the UN weapons inspectors were thrown out of Iraq in 1998, they had already destroyed thousands of litres of anthrax and other germ agents; but a whopping 17 tonnes of imported medium for growing germs were still unaccounted for. Iraq is since thought to have developed mobile germ laboratories, with others concealed under hospitals and private homes. It is also known to have adapted crop-sprayers to spread biological agents, and to have experimented not just with bacteria but with viruses, such as camel pox. It may (along with North Korea) have stocks of the smallpox virus.

Smallpox merits particular attention because it is the only disease that has ever been eradicated in nature. The last case was in 1979, and most people are now “immunologically naive”—as vulnerable to infection as America's Indians were to the poxes of the old world. America and Russia agreed to keep samples for research, and a few rogue regimes are thought by the CIA to have kept them for use as weapons.

“Dark Winter”, a government study completed in June 2001 that modelled the effects of a smallpox attack on three American cities, concluded that within two months there would be 1m dead and twice as many infected. America has rapidly secured enough doses of vaccine to inoculate the entire country and now wonders whether to do so. In the next few weeks, President George Bush is expected to announce a plan to vaccinate 500,000 health workers, with up to 7m-10m to follow. Other countries, too, are accumulating vaccine and wondering how many to inoculate (see article). In every million people given the smallpox vaccine, two or three may die and hundreds will suffer serious side-effects.

Spotting the symptoms

The anthrax letters sent last year were spotted by a Senate staffer who had recently undergone security retraining. Without such luck, or if an attacker were to release pathogens more surreptitiously, there would be as little immediate sign of an attack as of the arrival of the 'flu season. Early detection is crucial. Guarding places at risk may require devices that continuously monitor the air, sniffing for spores and other particles. Several different research groups are looking for antibodies that bind to the surface of biologically threatening molecules, fitting like a key in a lock, which could be the basis of both detection and treatment.

The more likely first sign of an attack or epidemic, however, will be the eruption of illness in people exposed to it. Spotting such a flare-up is the job of regional public-health offices that monitor reports of unusual symptoms from doctors. If something unusual crops up in the United States, samples are sent to one of the 158,000 state and local laboratories that can do biological culture analysis to identify the disease. The system needs to be expanded to collect other data that could give early warning of something out of the ordinary, such as sales of cold and 'flu medicine in chemists, or calls to emergency services with complaints of respiratory problems. New York has built a network to look out for sudden spikes, but most of the country has made little progress.

In America, the public-health system is anchored in the Centres for Disease Control (CDC) within the Department of Health and Human Services (DHHS). A bioterrorism-preparedness bill passed in the aftermath of the anthrax letters allocated $1.1 billion to the DHHS, with most of that going to the CDC and the rest to the Health Resources and Services Adminstration, which oversees hospitals round the country. The money will go towards the regional laboratory system and the health-alert network that allows doctors to communicate news of isolated cases to epidemiologists. Technicians are being trained to recognise unfamiliar pathogens. Hospitals and clinics have been given reference cards listing unusual symptoms and what precautions to take when they appear.

The CDC also manages a national pharmaceutical stockpile. This store of antibiotics, vaccines and other drugs is spread around eight centres to ensure that emergency medical supplies can be rushed to anywhere in America within 12 hours. The stockpile also has a “virtual” component, consisting of arrangements with manufacturers to boost production of particular drugs at short notice.

What goes into the stockpile and what tests the surveillance network can perform depend on research. The National Institute of Allergy and Infectious Diseases, one of the National Institutes of Health, has received the largest budget increase ever to go to one of the institutes. With its $1.75 billion budget for 2003, the institute plans to spend $521.1m building new laboratories secure enough to house the most dangerous pathogens. Basic research, including genomic sequencing of agents, will consume $440.6m.

Another $591.9m will go on discovery and development of drugs, vaccines and diagnostic techniques. Clinical trials—testing these techniques and medicines on people—account for the remaining $194.3m.

Tangled command chains

The rest of the DHHS money is earmarked for hospital planning. Years of underfunding of public hospitals and the efficiency drives of the private sector mean that hospitals do not have the “surge capacity” to cope even with a heavy 'flu season, let alone a wave of smallpox cases. A report published in October 2000 by the Stimson Centre, a think-tank in Washington, DC, was highly critical of the state of the public-health network. Amy Smithson, its author, argues that the state grants being given out by the CDC still do not reach deeply enough to the local level, where both detection and response first occur.

The interaction between local, state and federal authorities in America becomes even more fraught in an actual emergency, and clear lines of command are only just emerging. The creation of the Department of Homeland Security should consolidate some of the overlapping responsibilities. The CDC has also made an effort to clarify the lines of authority.

Constitutionally, protection of public health is a matter for the states. Some, such as Colorado, had developed bioterrorism plans before September 11th 2001. To encourage the others, and to introduce some consistency across the country, the CDC commissioned the law departments of Georgetown and Johns Hopkins Universities to create a model act designed to give states the necessary powers to detect and contain sudden outbreaks of disease.

The model act includes strict quarantine powers, and establishes the governor's right to declare a state of emergency in which public-health officials gain the authority to order doctors to treat people, and people to accept treatment on pain of arrest. Civil libertarians think these powers are dangerously broad, and should be replaced merely with clear instructions to which the public would probably respond. But widespread panic may make firm orders necessary.

Out of rogue hands

The other vital tactic is to stop terrorists getting hold of the germs to make bioweapons. In the past, extremist “patriot” militias have bought pathogens from commercial laboratory suppliers, and national weapons programmes such as Iraq's have also bought them on the open market. The Bioterrorism Preparedness Act has tightened the regulations for scientists working with a list of 42 “select agents”, which the CDC will update on December 9th. Every place that uses the agents has to compile a complete list of stocks and track everything that is done with them.

Terence Taylor, the head of the Washington, DC office of the International Institute for Strategic Studies, argues that this is inadequate. New genetic techniques mean that firms that deal with dangerous organisms can often avoid the effort and expense of shipping select agents by ordering instead two separate kinds of harmless genetic material that can then be combined to make up a dangerous bug. Terrorists might do the same. Unlike the nuclear or even chemical industries, where certain materials or pieces of equipment have narrow military uses and can be controlled, the life sciences deal in raw materials that are widely found in nature.

Industry must therefore take more care to see that its creations are not used to do harm. Taking a lesson from the nuclear industry, which formed a world association after the accidents at Three Mile Island and Chernobyl, the IISS, along with the Chemical and Biological Arms Control Institute in Washington, DC, is designing a charter for the biotechnology industry. The aim is to build a forum in which the industry's leaders can discuss new developments, share information about risks and threats, and agree on a code of practice.

A parallel project at IISS, in collaboration with Lawrence Livermore National Laboratory in California, is considering setting up an expert panel from industry and academia to spot evolving areas of risk in the biological sciences. A research group in Australia, for example, has modified the gene of the bacterium that causes mousepox, a cousin of smallpox, so that the disease is no longer blocked by its vaccine. The American Society of Microbiology, which published the mousepox paper, has introduced a policy of challenging the authors of provocative papers to consider their wider implications.

Plenty of scientists have squared work on bioweapons with their consciences in the past, and 9,000 of them used to work in the Soviet biological weapons programme. Keeping them out of the world's arms bazaars is the task of the International Science and Technology Centre, which was set up to provide non-military opportunities for former Soviet weapons scientists. So far it has spent $482m, 23% of it on biotechnology projects. The G8 summit earlier this year agreed to step up spending to guard Russia's biological materials and skills, as well as its chemical and nuclear ones.

Unlike the treaties outlawing the spread of nuclear and chemical weapons, the Biological Weapons Convention has no means to check that countries which sign up then keep their promises. As yet, there is no reliable way of doing so (see article). Attention is now concentrated on encouraging governments to beef up national legislation and on strengthening national and international health-surveillance systems. (A new Global Emergency Outbreak Response Fund is being set up under the auspices of the World Health Organisation, but funded in part by the Nuclear Threat Initiative, a private American foundation.) The Australia Group, an informal cartel of like-minded governments that tries to control the trade in dangerous chemicals and pathogens and the equipment to produce them, has recently drawn up tougher export controls, which also cover the transfer of know-how and information. But germs and viruses, as every 'flu outbreak shows, have a way of keeping one jump ahead.

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Biological agents

An alphabet of horrors

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From The Economist print edition

What they are and what they do

Get article background

SCIENTISTS divide the biological agents currently considered as potential weapons into three categories:

Category A. These are the most dangerous and the easiest to spread; they produce high rates of death, are likely to cause panic and disruption, and require special preparation by the public-health system. The diseases caused are **anthrax**, **botulism**, **tularaemia**, **plague**, **smallpox** and **haemorrhagic fever**.

Category B agents produce fewer cases of disease in those exposed and have lower death rates, but are still reasonably easy to disseminate. The diseases they cause include some animal infections that can jump to humans, such as **glanders**, which occurs mainly in horses and donkeys; **brucellosis**, which causes herbivores to abort; and blights that affect crops.

There is a large overlap between preparing for bioterrorism and guarding against natural outbreaks; **foot-and-mouth disease** in 2000 did huge economic and social damage in Britain. A draft report on agricultural bioterrorism by America's National Research Council concludes that a terrorist armed with foot-and-mouth or soyabean rust could easily slip into the country undetected.

Category B also includes biological toxins that directly poison a host. Ricin, derived from castor beans, kills within days if swallowed, injected or inhaled. In 1978 Bulgarian agents killed a dissident émigré by using a specially-equipped umbrella to inject a pellet coated with ricin into his leg. Also in Category B are food and water-borne disease agents such as **salmonella**, **E. coli 157** and **cholera** bacteria.

Category C agents include emerging diseases that could be engineered to make them more suitable for mass dissemination. They are easy to find in some parts of the world, and can cause high rates of disease and death. They include **hantavirus**, **yellow fever** and tick-borne **encephalitis** viruses.

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Smallpox vaccine

Scrambling for safety

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A rare glimpse of preparations outside America

Get article background

THE World Health Organisation knows of around 200m smallpox vaccine doses around the world, not including America's new purchases. Much of the vaccine is old, frozen for several decades. Other types are new, produced mainly by two companies, Acambis in America and Bavarian Nordic, a Danish-German company. These are purer, and should have fewer side-effects. But Stephen Prior, of the Potomac Institute for Policy Studies, says their effectiveness has not been tested on humans.

Like America, most other countries stopped giving babies anti-smallpox jabs in the late 1970s. But activity has revived, especially in countries that are likely terrorist targets. Most governments (especially France's) are keeping policy secret. But here is what is known:

Australia is buying its first 50,000 doses of vaccine—the old type—from Aventis Pasteur, a French company. It plans to buy more next year, enough to contain an outbreak in big cities. Recent spending on anti-bioterrorism measures, including the Aventis purchase, comes to around A$11.4m. Australia's hospitals rehearsed for terrorist attacks before the Sydney Olympics two years ago.

In August, the government of **Israel** said it had enough vaccine for everyone in Israel, including the West Bank and Gaza. Some 15,000 emergency workers have been offered voluntary inoculation; most have turned up. The government is now worried that few of those inoculated have donated blood, which could be used to make antidotes for those who develop bad side-effects to the vaccine.

In **Britain**, the government plans to vaccinate emergency workers and to stockpile a lot of vaccine, though it won't say how much. It already has some old vaccine, and in April it bought £32m-worth of new vaccines from PowderJect, a British company linked with Bavarian Nordic. Britain's hospital readiness, however, is poor. A recent report from the National Audit Office found that one-third of health authorities had not tested mass-casualty plans.

In **Germany**, the federal government has asked the states to buy vaccine for every resident. It set the example by buying 6m doses (enough, when diluted, to vaccinate 24m Germans), with enough for 11m more people arriving in 2003.

In **Japan**, the government already has some vaccine, and hopes to have 10m doses by next year, with more to come. It has already spent some ¥5.7 billion ($47.5m) on bioterror preparations.

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New York city

Gotham in peril—again

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Corbis

Everybody acknowledges that New York city is in a mess, but nobody really wants to deal with it

Get article background

BARELY a day goes by in New York without a protest. Fire stations threatened with closing have received an outpouring of public support from little children (who give hugs) and their parents (who sign angry petitions). At City Hall rallies unfold on behalf of clinics, schools, subways and so on. The city is girding itself for a possible transit strike next month, mindful that it was just such an event in the 1960s that precipitated its last outright fiscal collapse.

The cause of all this friction: money. This week, the mayor, Michael Bloomberg, pushed through an 18% increase in property tax. More quietly, fees have been raised for things like parking, cigarette purchases, fire inspections and traffic tickets.

These moves will plug a $1 billion hole in the current fiscal year, ending in June 2003. But they will do little to resolve the $6.4 billion deficit projected for the next year. The city is required, by law, to balance its books; if the mayor fails, a state-appointed board takes over with extraordinary powers, including the ability to break contracts. That is pretty much what happened in 1975, leaving a legacy of lay-offs, wrecked government and a debt that continues to cost the city $500m a year.

New York's annual budget is $43 billion, but Mr Bloomberg contends that only $15 billion is within the city's own control. The rest is taken up by transfer payments from the state and federal governments for specific uses; by money pledged to cover debt repayments; and by legal commitments to pay things like city workers' pensions and medical care for the poor.

If the problems are dire, many of the suggested solutions are even worse. Some local politicians want a tax on stock trading—which might do more damage to Wall Street than Osama bin Laden did. There is also talk of introducing taxes on the wealthy (persuading them to move to Connecticut) or on commuters (persuading firms to move to Connecticut).

Despite all these things, the city's crisis seems to be remarkably short of rancour. Even the protesters accept that New York has been hurt by the global economic recession, Wall Street's woes and September 11th. Mr bin Laden has inadvertently created a distinctly unGothamlike consensus that painful decisions

must be made.

Less welcome is a dangerous tendency to exaggerate the impact of the World Trade Centre attack, and to ignore long-term imbalances in the budget. Despite all the bad news, neither the national nor the local economy is doing particularly badly. The city's unemployment rate remains below 8%, less than it was five years ago. The current crunch is the product not of the economy, but of poor political decisions.

New York Democrats are born spenders. This time the Republicans have also been at fault. Rudy Giuliani certainly began his mayoralty as a model of fiscal rectitude: his first budget, for 1994-95, actually reduced costs and he cut the number of city employees (see chart). But in the bubble economy of the late 1990s he lost his grip. The same, broadly speaking, goes for the state's governor, George Pataki, who has to patch up a $10 billion state deficit.

Put in the unfortunate position of cleaning up the post-windfall mess, Mr Bloomberg's first instinct was to minimise the pain. Earlier this year, when the first cracks appeared in the city's finances, he won permission to raise $1.5 billion in operating expenses through a bond issue, an unrepeatable tactic. Now city agencies have been told to save money, with Mr Bloomberg pledging to reduce his own office's costs by a fifth. A hiring freeze has recently gone into effect and the school administration announced the lay-offs of non-teaching related employees.

By this stage, Mr Giuliani would probably have clouted several trade-union leaders. Not the pragmatic Mr Bloomberg. Rather than using the crisis to damn the inefficiency of municipal workers, he has become their champion, arguing that severe cuts would do more to harm the city by damaging services than higher taxes would by raising costs. Teachers, policemen and firemen have all got wage rises.

There is some method in this madness. For instance, after decades of unsuccessful efforts by his predecessors, Mr Bloomberg has secured direct control over the city's schools. That has not only raised hopes of improving education, but also given him a chance to rein in the notoriously spendthrift school-construction authority.

There are political reasons to compromise, too. When Mr Giuliani took office, local government was loathed. Now many city employees, particularly cops and firemen, are heroes. The property-tax hike followed an unsuccessful effort to close eight fire stations and seven little-used centres for old people. And the city has had to increase some services, notably by assigning 1,000 policemen to anti-terrorism work.

But compromise can go only so far. This week, Standard & Poor's cut the city's debt rating to “negative”. The city is on course to spend as much this year as last (which included the massive one-time costs of the Trade Centre attack). Pushing up taxes may keep public-sector jobs, but it hurts private-sector ones. E.J. McMahon, an analyst at the Manhattan Institute, a conservative think-tank, reckons the new property tax will cost the city 62,000 jobs, 2% of the total. And, for all his pragmatism, Mr Bloomberg's popularity has begun to slide.

Hence the feeling that serious reform is merely being postponed. Such reform would surely involve competitive bidding for municipal services (notably buses). It would also require changing the contracts for city workers: making them stump up bigger health-care contributions and work longer weeks, with less overtime.

Mr Bloomberg probably knows this, and his tactics perhaps deserve the benefit of the doubt. The media tycoon confounded his critics by winning the mayoralty; the schools deal was also a triumph. A good guess is that he is betting that, as the reality of New York's dire circumstances sinks in further, his own ability to act will expand. Someone, after all, will have to make those painful decisions New Yorkers go on ineffectually talking about.

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State budgets

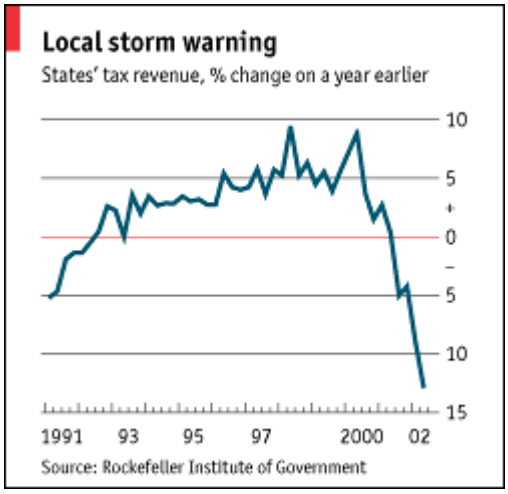
Too much trouble

Nov 28th 2002 | WASHINGTON, DC
From The Economist print edition

Every time you look at state budgets, they get worse. What can be done?

HALF of America's governors were newly elected this month. Some may prefer to have lost. This week a survey by the National Governors Association and state budget officers confirmed that two-thirds of the states had to cut spending plans by $12.8 billion in the latest fiscal year (which ended in most cases on June 30th). That happened even though those plans had already set out to reduce growth in spending from 8.3% in 2001 to only 1.3%.

This is just the start. State revenues fell by more than 6% last year, the first absolute fall since 1945. The National Conference of State Legislatures now thinks that this fiscal year the states will be $17.5 billion in the red, or 3.6% of total spending. Tax revenues are lower than expected in 33 states and spending is higher in 29. All the states except Vermont are constitutionally required to run balanced budgets and most of the "easy" spending cuts or tax increases have been done. Next year will be a bloodbath.



The reasons for the mess are well known. States cut taxes and raised spending too much in the boom years of the 1990s, mistaking temporary windfalls from capital gains (among other things) for a permanent increase in revenues. The bubble burst just when states began to face more demands on their main spending programmes, especially Medicaid.

This safety net, which provides medical assistance for the poor and is run jointly by the states and the federal government, is now in greater use because of the spiralling cost of private health-care plans (the number of uninsured Americans has soared as a result). Meanwhile, Medicaid's costs have risen with prescription-drug prices. Medicaid spending rose 13% last year, and it is now the second-largest item of state spending, after education.

The question is: what can be done? This is the third, and worst, state-budget crisis in 30 years. Critics point out that fiscally profligate Washington is cutting taxes on the wealthy at a time when cash-starved states (in words President Bush once aimed at Congress) are balancing their budgets "on the backs of the poor". The same critics think the federal government should come to the aid of the states.

The governors originally asked for $9 billion extra in block grants for Medicaid and social services. The administration scotched that idea in July. A $5 billion version later fell by the wayside. Some local-government experts want to resurrect "revenue sharing"—direct cash transfers from Washington, a scheme from the 1970s.

On a modest scale, some federal help would be justified. It is, as the National League of Cities says, "a colossal failure" that Congress and the president have promised the states $3.5 billion to help train and pay for "first responders" in the case of a terrorist attack—and have since done nothing about it.

But, argues John Shannon, a veteran state-budget watcher, if the federal government were to step in to bail out the states now, it would disrupt the only time-tested way of improving America's federal budget system: through crisis. Over the past decade of splurging, states have created a lot of (to put it politely) low-priority programmes. Virginia has $500m-worth of such wasteful spending. Bailing out the states would remove pressure for change.

More important, the states' tax-raising systems are a shambles. They rely on taxing goods at a time when the economy is based on services. Some of their crisis measures—such as taxing cigarettes—have only added to that imbalance. All the same, Louisiana's voters have just approved a “tax swap”, repealing the state sales taxes on utilities and groceries in exchange for an income-tax rise. And New Jersey has tightened up its corporate-tax system. The next year or two will be painful; they are also necessary.

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The Louisiana Senate race

Unfinished business

Nov 28th 2002 | NEW ORLEANS
From The Economist print edition

A close and dirty contest for the last Senate seat

WHEN Senator Mary Landrieu saw torrential rain sweep into New Orleans on November 5th, she had to know she was in trouble. Rain is a disaster if you are a Democratic candidate in Louisiana. Even if you persuade your campaign volunteers to go outside and wave your signs, passing motorists tend to ignore them. If your supporters get around by bus or on foot—as do a disproportionate number of black voters, the Democrats' chief backers—they may not make it to the polls.

Under Louisiana's quirky election laws, that day's contest was a primary. Had Ms Landrieu won more than half the votes, she would have been re-elected. In the event she got only 46%, so now she has to face the Republican who finished second, Suzanne Haik Terrell, in a run-off on December 7th. That will decide whether the Republicans have a one-seat or two-seat majority in the Senate; it may also mark the ousting of the Democrats from one of their last southern fortresses.

The rain was not the only thing that went wrong for the senator on November 5th. The Republicans shrewdly ran three well-known candidates from different parts of the state: together they took 51% of the vote. Now Ms Landrieu faces not just Ms Terrell, who is the state elections commissioner, but also the might of a nationally ascendant Republican Party undistracted by other Senate races.

The two women have some obvious similarities. Both are from well-off New Orleans families. Both are in their late 40s, and generally viewed as moderates. Each favoured George Bush's tax cut and the congressional resolution authorising the use of force against Iraq. Ms Landrieu's slogan is “Louisiana first”. Ms Terrell's embraces “Louisiana values”.

Backs against the wallpaper

The likeness cuts two ways. Some voters may see little reason to replace the incumbent. Then again, Ms Landrieu can hardly depict Ms Terrell as an extremist (a tactic that helped her win by a whisker in her 1996 race against Woody Jenkins, a much more conservative sort). In the primary, Ms Landrieu boasted of voting with Mr Bush three-quarters of the time; now she is working furiously to depict Ms Terrell as a rubber-stamp for the president, and look all independent herself.

For her part, Ms Terrell is trying to paint Ms Landrieu as an out-of-touch, tax-and-spend, Washington-loving liberal. During the primary, the Republicans ran television advertisements that attacked Ms Landrieu for living amid walls festooned with “elegant fleur-de-lis wallpaper” in a “million-dollar Washington mansion”. This leaves Ms Terrell open to charges of hypocrisy: she lives in a swanky street, and her home is anything but shabby.

Ms Landrieu's supporters have hit back by trying to tarnish Ms Terrell's reputation for probity. She took over her present job from a man who is now in prison on corruption charges, and she has won praise for backing a proposal to have the post abolished. Now the Democrats are insinuating that Ms Terrell repaid a campaign contributor by purchasing overpriced voting machines that break down in Louisiana's humid climate.

There are more solid disagreements between Ms Landrieu and Ms Terrell, the most substantial of which is over abortion. In a televised debate last weekend, Ms Terrell declared, “I am 100% pro-life. As a practising Catholic, I did not leave my faith as did Mary Landrieu.” In southern Louisiana, few insults sting more—or presume more—than calling someone a bad Catholic. Ms Landrieu, who supports most forms of abortion, denied a loss of faith and accused Ms Terrell of inconsistency: she was listed as

honorary co-chairman of a 1994 Planned Parenthood event. Ms Terrell insists that was a mistake.

Social conservatives probably still think Ms Terrell is more pro-life than Ms Landrieu. Even so, squabbling on the right continues. The Republican governor, Mike Foster, has endorsed Ms Terrell, but only after criticising the negative tone of his own party's propaganda. Congressman John Cooksey, who finished third in the primary, has accused Ms Terrell of running a “smear campaign” against him.

Whatever the divisions among Republicans in Louisiana, the national Republican machine is solidly trying to win the seat. Vice-President Dick Cheney has been in Louisiana to help Ms Terrell since the primary. The president himself is due in Louisiana four days before the vote.

Ms Landrieu's problems reflect those of the Democrats in general. When asked if she will invite Al Gore or Bill Clinton to campaign for her, she dodges the question. She has already collected the biggest plum the national Democrats can offer her: an assurance from the Senate Democratic leader, Tom Daschle, that she will keep her seat on the Appropriations Committee if she is re-elected (though the Republicans may try to block this). Congressional pork is a much appreciated local delicacy.

It may seem unfair if Ms Landrieu loses. She has stuck to the middle of the road in a Clintonesque way. Since the Democrats' loss earlier this month, she has offered ideas that appeal to both the poor and the middle classes, such as a plan to exempt the first $10,000 of a worker's salary from the federal payroll tax.

A poll this week gave Ms Landrieu a 16-point lead. But many experts still think the odds are against her. Although the Democrats have held the seat for 119 years, Louisiana, like so much of the South, seems to be slipping away from them. Mr Bush carried the state by eight percentage points (and by 46 points among white voters). Republicans control most of the statewide offices. Unlike the down-in-the-dumps Democrats, they are full of confidence.

Ms Terrell could win just by getting everyone who voted for her party in November to return to the polls. Ms Landrieu has to get out Democrats—particularly black Democrats—who didn't show up then. Her supporters have been handing out leaflets in black neighbourhoods and visiting black churches to urge members to vote. A few prominent black leaders who declined to support her in the primary have finally come around. Ms Landrieu may still make it. But even if she wins another squeaker, the Democrats need a better strategy in Louisiana than fighting over tiny slivers of the electorate and praying for sunshine on election day.

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War on the campus

The West Bank and the Charles

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Are Israel's attackers, and its defenders, going too far?

IN 1996, Tom Paulin, an Oxford don and poet, condemned the literary establishment for tolerating T.S. Eliot's anti-Semitism. Now Harvard stands accused of tolerating the same “malignity” in Mr Paulin. In April he told an Egyptian paper that he thought “Brooklyn-born Jews” who tried to settle in the West Bank should be shot. Despite that, Harvard invited him to deliver a lecture on poetry. The offer was retracted after protests from students and alumni, but renewed when, in the name of free speech, the English faculty voted, with only two abstentions, that he be asked to come. Mr Paulin has accepted.

Harvard's shilly-shallying reflects the current of self-doubt coursing through American academia. One question is where criticism of Israel and its American supporters ends and anti-Semitism begins. Another is what form this criticism should be allowed to take on campuses, many of which have extremely strict “hate codes” for any perceived racism.

Support for Israel remains strong in America. Nevertheless, a “divestment” campaign is asking universities across the country to stop investing money in Israeli firms and in other firms that have Israeli subsidiaries or engage in joint ventures with Israelis. Harvard's investments in such firms, which include Intel, AIG and General Electric, add up to more than $600m. A divestment petition at Harvard and the Massachusetts Institute of Technology has won thousands of signatures.

The spread of the divestment campaign in recent months has added to fears that anti-Semitism is taking hold in American universities. Nasty incidents of intimidation have taken place. Harvard's president, Larry Summers, argues that the divestment campaign unfairly castigates Israel because it is a Jewish state. “My definition of anti-Semitism”, says Alan Dershowitz of Harvard Law School, “is taking a trait that is universal and singling out only Israel for exhibiting that trait.”

Opponents of divestment argue that many governments commit far worse sins than Israel and yet are ignored by the divestment campaigners. Mr Dershowitz is working with students to prepare mock divestment petitions that would ask universities to divest from Syria, Saudi Arabia and other countries. He says that, though he would be willing to sign divestment petitions for Israel and the rest together, he would not sign one aimed at Israel alone.

The advocates of divestment, recalling that the same weapon was once directed at apartheid South Africa, insist they are not anti-Semitic. Their target, they say, is the relationship between the United States and Israel. Sam Halabi, the leader of Harvard's Justice for Palestine, a student organisation, argues that America in effect finances the occupation and settlement of Palestinian territory. The very fact that Israel is a democracy, unlike the dictatorships around it, suggests it will change its behaviour in response to such pressure.

The row has produced some weird scenes. This month a group of Harvard students launched a “Buy Israel” campaign, selling such things as Israeli military T-shirts, the proceeds from which will be used to buy care packages for Israeli soldiers. At Yale, pro-divestment students set up a “checkpoint”, supposedly imitating Israeli checkpoints in the West Bank, where students in military uniforms, carrying fake firearms, stopped fellow students as they went to class.

Another front in the war is to be found on the Internet. Many scholars of Islamic or Middle Eastern affairs have been listed on a website called Campus Watch, established by Daniel Pipes, an academic, and the Middle East Forum, a pro-Israel think-tank. In September, Campus Watch posted the names of eight academics whom it accused of downplaying the dangers of militant Islam or exaggerating Israel's faults. About 100 other academics, in a gesture of solidarity, asked it to add their names to its list. Campus

Watch obliged, calling them all “apologists for suicide bombings and militant Islam”.

John Esposito of Georgetown University, one of the website's original eight, says he was picked out because he has argued that extremist Islamists are a tiny minority of the Muslim world. After the website posted his name, Mr Esposito began to get hundreds and sometimes thousands of e-mails every day. Some of them contain death threats. Others accuse him of being anti-Semitic, anti-Israeli or un-American.

Campus Watch's defenders say it is making academics, many of them less esteemed than Mr Esposito, publicly accountable for their views and indeed lies (such as saying that no Israelis were killed in the World Trade Centre). And Campus Watch is helping people to exercise the right to free speech (without asking people to shoot each other, as Mr Paulin did). But Mr Esposito still feels targeted: this, he says, will make it even harder for universities to discuss Israel than it already is.

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The end of the port strike

Dock around the clock

Nov 28th 2002 | SAN FRANCISCO
From The Economist print edition

America's most successful union loses jobs, but keeps its muscle

AP

Trade ahoy

SEVEN weary months of negotiation ended at 10.30pm on November 23rd with each side claiming victory. The dockers who work in America's 29 Pacific ports, represented by the International Longshore and Warehouse Union (ILWU), and their employers in the Pacific Maritime Association (PMA) can both claim hard-won gains in a contract that will cover the next six years.

The key change for the employers is the introduction of information technology such as bar-codes. Until now, data on cargo have been laboriously transcribed by members of the ILWU, rather than being electronically transferred between computers. More automated ports, such as Rotterdam and Singapore, can handle up to five times as much cargo per square foot as the Long Beach-Los Angeles complex.

The union has accepted that at least 400 maritime-clerk jobs will go, although it has extracted a guarantee of lifetime employment for all the 1,600 current clerks. The absolute number of jobs matters less to the union, however, than its jurisdiction over types of work. Its main gain was to win back control of the planning of how goods are stored on the docks and then sent out to railways and lorries. This had long been union work, but the employers diverted it to data-processing centres in Utah.

Union members have also kept their ancestral right to high wages. Pay and pensions will both rise. A union member retiring after 35 years can look forward to an annual pension of $63,000, a 58% increase on the current $39,900. The employers will pay for this, and for the 100% health-care coverage retained by the union, out of the increased profits they will make from greater efficiency.

Last year the ports handled goods worth $310 billion. For retailers and manufacturers who rely on goods and materials from Asia, and access to its markets, this trade is vital. When the employers shut the ports for ten days in October, five car factories had to shut down as their “just-in-time” supply chains ground to a halt. President Bush, invoking the Taft-Hartley act for the first time in 24 years, sent a federal negotiator to bring the sides together within the 80-day period called for in the act. That negotiator has earned his turkey on this week's Thanksgiving Day.

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Lexington

Good ol' Strom?

Nov 28th 2002
From The Economist print edition

Well, it depends on your perspective. But the old rogue certainly changed American politics

IN 1964 Strom Thurmond made history by switching parties to become the first Republican Senator from the Deep South since Reconstruction. On December 5th he should make history of a different sort, by becoming Congress's first centenarian.

It is hard not to have a sneaking admiration for Mr Thurmond's endurance. Granted, it would have been more sensible if he had retired after his seventh term, at 93. Once famous for his sharp wit, he now operates in a mental fog; once a fitness fanatic, he is now confined to a motorised wheelchair. He spends every night in a military hospital, and conducts most of his business through his veteran chief of staff, Robert “Duke” Short. But the old devil's life force remains an inspiration to lesser men. He married his second wife, a 22-year-old former Miss South Carolina, when he was 66. The happy couple went on to have four children, and he retains his reputation as a ladies' man despite his advanced age and odd-looking hair transplant. “When he dies,” a fellow senator once remarked, “they'll have to beat his pecker down with a baseball bat to close the coffin lid.”

Most men would be happy just to be remembered for that. Mr Thurmond will go down in the history books because he pioneered one of the most important political changes in American history: the shattering of the Democratic Party's monopoly of power in the South. In 1950 the GOP had only two congressmen from Dixie, and no senators. Now the party has a 23-seat advantage in the House and a fair lead in the Senate.

“When he dies, they'll have to beat his pecker down with a baseball bat to close the coffin lid”

Yet his motives were not admirable. He switched to the Republicans for a single disgraceful reason that will always haunt both his reputation and that of his new party: race.

Young Strom grew up in a world in which the Democratic Party in the South was synonymous with segregation. He left the party in 1948 in protest against Harry Truman's support for civil rights, and ran for president as the candidate of the segregationist Dixiecrat Party. Returning to his ancestral party, he led the resistance to civil rights, and still holds the record for the Senate's longest filibuster: a 24-hour-18-minute harangue against a civil-rights bill. He joined the Republicans because he thought that they would be sounder on race.

The racism that explains Mr Thurmond's political apostasy also explains the Republicans' rise in the South. Barry Goldwater broke the Democrats' hold on the South, using his decision to vote against the civil-rights act to win the 1964 presidential vote in five southern states. Richard Nixon's southern strategy was designed to capitalise on the white backlash against civil rights. Ronald Reagan launched his presidential campaign in one of the strongholds of segregation, Philadelphia, Mississippi.

Hardly a pretty picture. But before trashing ol' Strom and his creed, it is worth remembering that the rise of southern Republicanism has brought benefits as well as losses. Before Mr Thurmond's apostasy, the Republicans were little more than an esoteric cult in the South. Now southern voters have a choice. They also have more influence on American politics. Before Mr Thurmond's desertion, the Democrats took the South for granted and the Republicans ignored it; now, in the era of Bill Clinton and George Bush, politics sometimes looks like a game played entirely by southerners.

You can even argue that Mr Thurmond brought ideology to American politics. Before 1964, both parties had their conservative and liberal wings, and fixers like Lyndon Johnson had enormous freedom. The battles over race and culture have left voters with a much clearer idea of what and whom they are voting for.

Black, white and red all over

There are also grounds for arguing that race has become a less poisonous serpent in American politics—something that Mr Thurmond's own career shows. During one of his long-winded attacks on civil-rights legislation, a fellow senator remarked to an aide: “Listen to ol' Strom. He really believes all that shit.” Yet most of the evidence suggests that Mr Thurmond believed in one thing much more than racism: his own political career.

He quickly softened his views when South Carolina's blacks (who make up 30% of the population) started voting in large numbers. After a black-white coalition defeated one of his protégés in the 1970 governor's race, Mr Thurmond reinvented himself as an economic rather than a racial conservative. He hired a black staff member, doled out pork to black mayors as well as white, and re-engineered his constituency machine (which is reported to be one of the best in the country) so that it took care of blacks as well as whites. In the 1980s he voted for the voting-rights act and the Martin Luther King holiday. In his re-election in 1990 he won 20% of the black vote.

Mr Thurmond quickly softened his views on race when South Carolina's blacks (who make up 30% of the population) started voting in large numbers

The Republican Party too has moved on. It may attract paltry black support; and J.C. Watts's imminent retirement may be depriving it of its only black congressman. But the modern Republicans no longer embrace race-charged issues as enthusiastically as they once did. The hard-line segregationists who waved Confederate flags at Mr Thurmond's rallies are a dying breed. Unlike his predecessors, President Bush's main aim is no longer trying to prise conservative southerners from the Democrats (he's got them already). He is trying to appeal to floating voters who are highly suspicious of bigotry. His signature themes are lower taxes and national security, not explosive cultural issues. And he has given blacks conspicuous jobs in his team.

Both the Senate and the White House will put on birthday parties for Mr Thurmond on December 5th. His native state is in the process of naming yet more high schools, government buildings, athletic centres, dams, malls and streets after him. Mr Thurmond is moving into a nursing home close to the house where he grew up. He can contemplate his legacy, while he looks out over pecan trees that he planted as a boy.

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Mexico's farmers

Floundering in a tariff-free landscape

Nov 28th 2002 | CULIACAN, SINALOA
From The Economist print edition

Corbis

Mexico had a breathing-space under NAFTA to reform its agricultural practices. Time is running out fast

Get article background

ON JANUARY 1st 2003, as the North American Free-Trade Agreement (NAFTA) enters its tenth year, a new phase of tariff reductions on farm produce will take place. The United States will eliminate tariffs completely on several Mexican items, including limes and winter vegetables. Mexico will eliminate them on a range of produce, including wheat, barley, rice, apples, potatoes and pork. This moves the two countries a step closer to the point, in 2008, when the last few tariffs on agricultural produce are due to be scrapped.

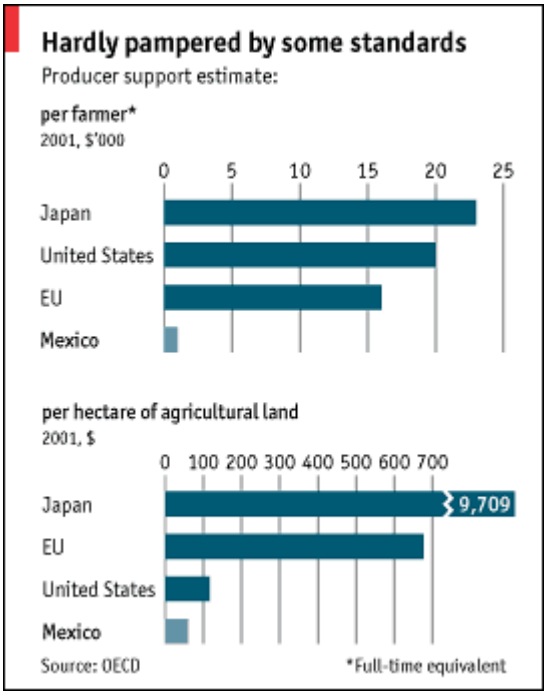
The Americans may be cheering, but Mexicans are not. These tariff reductions have occasioned the gloomiest predictions about the decline and fall of the entire agriculture sector, the end of the Mexican countryside, even the demise of the tortilla, the staff of Mexican life. In 2001, Mexico ratcheted up a deficit of more than $2 billion in farm trade with America. Once tariffs go, the country will surely be flooded by cheap American imports. Opposition politicians have been calling for the tariff reductions to be postponed, and even for NAFTA to be renegotiated.

Slim chance of that. But any Mexican government has to listen seriously to farmers, who make up a huge political constituency. About 8m people—22% of Mexico's active labour force—work in the countryside, although they generate only 4.4% of GDP. Yet rather than taking any difficult, strategic decisions, the government of President Vicente Fox has spent the past few months producing a tranche of subsidies, price supports and anti-dumping measures (such as a tariff of 46.5% on *Yanqui* Golden Delicious apples) to appease the farming lobby. On November 18th, the government announced a $10-billion programme to “armour-plate” farmers against the supposed effects of the January tariff reductions, including higher price supports for certain grains.

Unfortunately, these measures have appeased nobody in Mexico, while escalating what is, in effect, a trade war with the United States. Farmers' groups in Mexico are unimpressed with the armour-plating, arguing that the $10 billion is in fact a re-formulation of existing funds. On the other hand, the only items that now seem to be freely traded between Mexico and the United States are recriminations over each country's subsidies. This week the under-secretary at the Department of Agriculture in Washington, J. B. Penn, argued that Mexico's subsidies “question the efficacy of agreements like NAFTA”.

Sheer hypocrisy, the Mexicans reply. They are merely

responding to President George Bush's farm bill, which will lavish about $180 billion on American farmers over the next ten years. Farmers north of the Rio Bravo are much more heavily subsidised than Mexicans (see charts); but they argue, in turn, that their subsidies are piffling compared with those enjoyed by farmers in Europe and Japan.



A subsidy war with America is one the Mexican government can never win in terms of hard cash. Neither will it help Mexico's farmers in anything but the shortest term, since subsidies merely entrench the manifest inefficiencies in the system. One government official in the rural state of Sinaloa, in the north-west, estimates that about 15% of subsidies, siphoned off by corrupt bureaucrats, never reach the farmers and producers in any case. More thoughtful Mexican farmers, such as Eduardo Palau in Sinaloa, would rather see steadily liberalising trade than subsidies.

The 2003 tariff eliminations will, in fact, make almost no material difference. These tariffs have been gradually reduced since 1994; most of them will come down from only 1.5% or 2% to zero on January 1st. The real problem is not NAFTA and American subsidies, but Mexico's failure to adapt to trade liberalisation in general since the mid-1980s, when it first acceded to the General Agreement on Tariffs and Trade (GATT). Since gaining access to all those shiny new markets in America and the European Union, Mexican agricultural production has either declined, collapsed or grown only slightly. For all types of beans, for instance, production fell on average by 0.7% a year between 1980 and 2001. Wheat production has fallen by 57% since 1980, and soyabean production by about one-sixth. NAFTA merely accelerated all this. Mexicans, and world markets, have preferred cheaper alternatives.

It is the high cost of Mexican farming that makes it so uncompetitive

Mexican governments failed to take advantage of the ten-year transition period, while the tariffs were being phased out, to invest in infrastructure improvements such as irrigation. It is the high cost of Mexican farming that makes it so uncompetitive. Mr Palau argues that farming in the state of Sinaloa has become almost as efficient as in the United States, with yields per hectare increasing from 2.9 tons in 1981 to 8.5 tons in 2001. But local farmers are still going out of business because their costs—from diesel to electricity to credit—are about a third higher than those north of the border. Poor transport makes a crucial difference: it costs about three times as much to deliver corn by rail from Sinaloa to Mexico city as it does to ship it there from New Orleans via Veracruz.

These are what the Americans this week politely, and correctly, called Mexico's “structural” challenges. While the country's farmers are being exposed to the full force of world competition, they are saddled with artificially high costs because much of the rest of the economy consists of public or private monopolies sheltering behind legal and constitutional barriers to competition.

The worst moment will come in 2008, when tariffs are eliminated on American corn. Because corn is so central to Mexican agriculture—using about 55% of cultivated land—it was afforded special protection under NAFTA in 1994, with a tariff of 206% on imports over 2.6m tons a year and a 15-year phase-out to zero. But so feebly have Mexican farmers risen to the challenge of feeding their own protected market that, since 1994, Mexican governments have regularly imported much more than the import quotas. Furthermore, they have not collected the revenue from the tariffs, arguing that they need cheap corn to keep the poor supplied with tortillas.

There are about 3m corn-growers in Mexico, with an average of five dependants each. Mexico's government has squandered the first ten years of NAFTA's transition period. It now has five years left to make its farms competitive. Don't hold your breath.

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Haiti

Frustration boils over

Nov 28th 2002 | PORT-AU-PRINCE
From The Economist print edition

AP

The Aristide regime is holding off its enemies—but for how long?

IT OFTEN seems that affairs in this benighted country can get no worse; and yet they have. After more than two years of political stalemate over flawed elections in May 2000, leading to the loss of $500m in vital international aid, continuous opposition protests are shaking the government of President Jean-Bertrand Aristide, once seen as Haiti's saviour.

On November 17th some 15,000 people marched in Cap Haitien, and a former Haitian army officer with coup experience, Himmler Rebu, urged Mr Aristide to resign. On November 20th, four people were shot dead in Petit-Goave. Two days later, government counter-protesters filled the streets of Port-au-Prince, the capital, with burning barricades.

Could Mr Aristide be on his way out, only 21 months into his five-year term? He lost power in a coup once before, after all, and the United States had to reinstate him. Last weekend brought rumours that he was about to be airlifted out of the country by an American air force plane spotted at Port-au-Prince airport; but it was there, apparently, only to deliver Thanksgiving turkeys to the American embassy.

The Americans are watching carefully, especially since a boatload of more than 200 Haitians made it to the shores of Florida late last month. They want no repeat of the exodus of 1993-94, when thousands of Haitians took to the seas and ended up in camps in Guantanamo Bay in Cuba—not least because those camps are now stuffed full of al-Qaeda detainees.

But frustration in Haiti may be reaching boiling point. This is the poorest country in the western hemisphere, and getting poorer. The value of the local currency, the gourde, has fallen more than 30% in the past six weeks. As Haiti imports so much of its staple food, inflation is running at 16% and price increases occur almost weekly. Businessmen speak of “a climate of fear”, and opposition groups complain that the government often uses local gangs, known as *chimeres* (after the fire-breathing monsters in Greek mythology) to break up protests with rocks and guns.

A gleam of light came last September, when the United States agreed to support the unfreezing of aid for Haiti if proper elections were held next year, a new electoral council was set up and public security was improved. But the government has dragged its feet. The deadline for creating the electoral council passed on November 4th, and the government was also miserly in compensating opposition leaders whose homes were burned by pro-government mobs last December. A national programme of disarmament has taken few weapons off the streets.

Most analysts believe, however, that the opposition still lacks the popular backing to force Mr Aristide out. He remains a symbol, though an increasingly tarnished one, of the country's determined independence. “Haitians are all about resistance,” says Richard Coles, a progressive businessman and former president of the Haitian Manufacturers' Association. “They would rather starve than kneel.” At present, starving looks a strong possibility.

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Ecuador

A colonel takes charge

Nov 28th 2002 | QUITO
From The Economist print edition

EPA

Now wearing a suit

His first urgent task: sweet-talk the IMF

Get article background

JUST 22 months ago, Lucio Gutierrez was under barracks arrest for helping to lead a coup which ousted Ecuador's then president. Last weekend he won the job for himself, beating Alvaro Noboa, a banana billionaire, in the run-off ballot with 54% of the vote. Yet the 45-year-old retired colonel faces a tough road ahead. Although he has proved himself flexible and keen to seek consensus, he is a political neophyte who faces a divided and hostile Congress. He must also deliver quickly on promises to fight corruption, increase social spending and create new jobs, if he is to avoid disillusioning the electorate.

Mr Gutierrez rose to fame after leading an uprising, backed by Ecuador's powerful Andean Indian movement, to overthrow President Jamil Mahuad in January 2000. After his six-month spell in jail, he formed his own Patriotic Society Party and forged an electoral alliance with the Indians' political arm, Pachakutik, trade unions and far-left groups to launch his bid for the presidency.

His military ties remain strong. He wore olive-green gear for much of his campaign, and most of his closest advisers are former army officers. His messianic drive to fight corruption and help the poor—he offered them, among other things, cheap housing and free health care—is also largely driven by his military background. Ecuador's armed forces see themselves as the people's protectors against the country's elites. Since the return to democracy in 1979, they have maintained strong ties with the Indians and rural folk.

Mr Gutierrez is the first candidate to harness the growing political power of the Indians, who make up about a quarter of Ecuador's population of 12m. But keeping their support and that of the trade unions may not be easy. Despite radical promises, tailored to these allies, to seek an alternative to dollarisation and to form a Latin American regional front to renegotiate the continent's external debt, Mr Gutierrez, who calls himself a “pragmatist”, has moved firmly to the centre.

He has to. Ecuador can no longer print money to cover spending shortfalls; it has annual debt-service requirements of around $2 billion, or more than one-third of the budget; it has no access to international capital markets, and on top of that the oil price is static. Somehow, Mr Gutierrez must secure a new loan from the IMF. To calm lenders' nerves, he has promised to honour his debt obligations, increase oil production by granting concessions to foreign investors, strengthen dollarisation and include business

types in his cabinet, which will be picked soon.

Yet treading this straight and narrow path could cost the president dearly. His Indian and leftist backers are already restless about his new-found moderation; and this coalition, in any case, holds barely a fifth of the seats in Congress. Nor can Mr Gutierrez hope to find support elsewhere. As a political outsider, he threatens the established support base of the main parties—especially the Social Christians, with 25 seats and the presidency of the chamber—and none of them wants to see his government succeed. His most likely allies could be the populist Roldosista Party, with 15 seats, and dissident members of the Democratic Left party.

At best, Mr Gutierrez—like the current president, Gustavo Noboa—may be able to construct alliances on a case-by-case basis. At worst, he will face a strong anti-government coalition that will try to frustrate him and kick him out of office. He will be lucky to survive longer than his two elected predecessors, both of whom were ejected before they had served 18 months.

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Ontario politics

Lurching leftwards

Nov 28th 2002 | TORONTO
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After Thatcherite austerity, a complete (though tactical) change of heart

ERNIE EVES is sparing no effort to erase his past. As Ontario's finance minister from 1995 to 2001, he led a conservative “common sense revolution” that reversed a decade of profligacy in Canada's richest and most populous province. In spite of lowering taxes and producing back-to-back budget surpluses for the first time in half a century, Mr Eves and his Progressive Conservatives won few hearts or minds as schools and hospitals closed, cities were starved of funds and government services were contracted out to business.

Mr Eves is now Ontario's premier, arguably the second-most-powerful job in Canada, and his revolutionary zeal has waned. An election is possible in 2003, and Mr Eves knows that politicians in Ontario have seldom lost votes by courting mainstream opinion. The Tories' message has thus abruptly shifted from “common sense” to “compassion”.

Mr Eves has shelved promised tax cuts, rather than take the axe again to public spending. Hardly a day passes without the “Ernie Eves government”, as the Tories now describe themselves, trumpeting a new health-care or education programme. Last month, the government said it was setting aside C$500m over the next two years to give Ontario “the best and toughest clean-water policies in the world”, closely modelled on proposals made by the leftish New Democrats.

The U-turn has been most abrupt in the electricity market. Mr Eves, who was once an investment banker, has upset his former colleagues on Toronto's Bay Street by pulling the plug on plans to encourage competition. He has bowed to trade unions and environmental groups by cancelling the privatisation of Hydro One, which operates one of North America's biggest power-transmission networks. Earlier this month, he brought competition in the retail market to a screeching halt by capping prices for the next four years and reimbursing consumers for a surge in electricity bills during this year's sweltering summer.

The electricity mess could have serious consequences for Ontario's finances. Without the Hydro One privatisation, which was expected to raise more than C$5 billion, Mr Eves will find it difficult to balance this year's budget—as he is obliged to under another pillar of the common-sense revolution, a balanced-budget law. The consumer rebates and losses at Ontario Power Generation, the provincially-owned generating company, have stalled repayment of over C$30 billion of “stranded debt” which the government took over from Ontario Hydro, the former power monopoly that the Tories broke up as a precursor to deregulation and privatisation. Much higher electricity charges are likely as investors shy away from putting money into new power plants in the province, once the price cap is lifted.

It is not yet clear whether Mr Eves's about-turn will rescue the Tories in time for the coming election. According to a recent Ipsos-Reid poll, support for the government has dropped since he took office. But other polls show that voters have a higher opinion of Mr Eves personally than of Dalton McGuinty, the Liberal leader. It is proving very hard for Mr McGuinty to offer an alternative to the new Tories, with their social consciences and their suddenly bleeding hearts.

A revival in the Ontario Tories' fortunes is unlikely to rub off on their struggling federal counterparts. Many who vote Progressive Conservative in provincial elections prefer to send members of the even-more-conservative Canadian Alliance to the federal Parliament in Ottawa. In the past three federal elections, the right-of-centre vote has split between the Tories and the Alliance (formerly the Reform Party), allowing the Liberals to capture all but a handful of Ontario's 103 seats in Parliament. Ontario's canny voters have elected different parties at the federal and provincial levels for 56 of the past 76 years.

Mr Eves's predecessor, Mike Harris, championed a united, right-wing federal party, and his name is still mentioned as a future leader of one. But the current premier shows little interest in federal politics. For now, he has his hands full distributing compassion in his own back yard.

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Japan

A bigger slice of a smaller pie

Nov 28th 2002 | TOKYO
From The Economist print edition

Japan's economy is more open to imports than ever—but now the gaijin have other things to complain about

TRADE disputes seemed so much livelier when Japan was an economic juggernaut. Western companies, especially American ones, complained that its economy was designed to shut out foreign goods and fleece local consumers, even as it flooded other countries with exports. Japan retorted that its companies, workers and products were simply better, and that western firms were too lazy to study Japanese consumers. (Remember when negotiators claimed that foreign meat was unsuitable for Japanese intestines? Or that foreign skis did not suit Japanese snow?) During the late 1980s, however, the government was pushed into concession after concession. Did it ever truly open up?

Judging by the noise level, things have improved. Although disputes among many of the world's trading partners still abound, Europe and America no longer routinely single out Japanese trading practices for criticism. Some of this has little to do with Japan. Under Bill Clinton and the younger George Bush, America has drifted further from its commitment to global free trade, and is thus less able to criticise others. The launching of the World Trade Organisation in 1995, with mechanisms for settling disputes, has also dulled the rhetoric of many trade battles. Clearly, however, Japan has also done its bit: imports have started to make a significant impact on its economy in the past few years.

Import levels depend on all sorts of economic factors, not just openness. But Robert Feldman, chief economist in Tokyo for Morgan Stanley, an American investment bank, points out that prices of many goods are now closer to their international levels—a sign that they are now easier to import. A weak economy has encouraged firms in some sectors, especially retailing, to compete harder on price, driving them to seek cheaper inputs from abroad.

Moderate reforms in Japan deserve some credit for this. Successive governments and parts of the bureaucracy have made an implicit, grudging admission that America was right, and changed some of the rules to make selling in Japan easier. The statist Ministry of Trade and Industry (MITI) was revamped to

push slowly for deregulation, and has had the word “Economy” inserted into its name as a nod to broader thinking. Still, many of Japan's bureaucrats and business methods are still geared towards protecting local companies, and foreign firms and governments see plenty of room for improvement. The real reason they have stopped complaining about import barriers is not because Japan is genuinely open, but because two big shifts in Japan's economy have prompted them to change the subject.

The first of these is Japan's economic stagnation, which has led trading partners to focus on weak overall demand, rather than just the non-tariff barriers that crimp demand for foreign goods. In the early years of the slump, America and others urged the government to prime the pump. The Liberal Democratic Party's addiction to public-works spending has grown more controversial over the past decade, however, and these days the American government focuses on Japan's mountain of bad loans, which prop up weak firms and forestall recovery. When American economic officials visit Japan these days, some expatriate businessmen complain, bad loans are not just at the top of the agenda—they are the agenda.

The second broad shift is that—partly through persistence and partly through reform—many more foreign firms have now established local operations in Japan. As their local business ties increase, American and European firms are focusing more on ways to make operating in Japan easier—some of which also help domestic firms—rather than trying to pry open new markets. The American Chamber of Commerce acknowledged this shift last year, when it renamed its biennial list of complaints the “US-Japan Business White Paper”, replacing the “Trade” white paper it has put out since the 1970s.

The most obvious complaints involve competition policy, since Japan's Fair Trade Commission still does a poor job of reining in monopolies and preventing collusion. Dignitaries from Europe like to tout the progress that the EU's competition directorate delivered during the 1990s. More transparent procurement policies would also please Japan's economic partners. So, too, would efforts to make it easier for foreign firms to invest directly in Japan, such as through mergers and acquisitions.

Besides these broad issues, problems in specific sectors still draw complaints, but these increasingly involve services, rather than tradable goods. Financial services are an exception, having been opened extensively to foreigners. By contrast, a whole range of business services—such as accountancy and the law—are highly segregated, slowing down Japan's integration with the rest of the world.

Although Japan is still maddeningly averse to change, its trading partners now look on it through different eyes. Its stubborn ways damage its own economy even more than those of its trading partners; sooner or later, it must change.

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Tehelka.com

Scandalous

Nov 28th 2002 | DELHI
From The Economist print edition

India's government has managed to drag out and redirect a corruption inquiry

WHEN elections loom, even whiskery political scandals can earn a new lease of life. In India, a poll in the state of Gujarat on December 12th is seen as having a crucial impact on the future of the coalition government. So the opposition has grabbed the chance to rake up some of the muckiest dirt flung at the government in recent years: when reporters equipped with spy cameras and posing as arms dealers were seen foisting wads of cash on 31 appreciative politicians, generals and officials.

The scandal was broken in March last year, by tehelka.com, a gung-ho website, and led to the resignation, among others, of the defence minister, in whose house one incident was filmed. He has since been reinstated, and the government managed to brush the affair away into the dusty corridor of a judicial inquiry into the evidence of real as well as fictitious corruption, and into tehelka's alleged motives.

Then last week it emerged that the retired judge heading the inquiry, K.Venkataswami, had been given a senior government job. The perception that this was a reward or inducement was fiercely and credibly denied. But it prompted Mr Venkataswami to resign from both the job and the inquiry, and worked the opposition into an indignant lather.

Yet the latest twist may suit the government. It will, after all, temporarily stall the inquiry. Meanwhile, as it happens, tehelka and its financial backers have found themselves the target of investigations of their own: from the customs, police, tax and anti-corruption authorities. Funds have dried up. Once boasting a staff of 120, it now has not one salaried employee. To its supporters, this looks like a witch-hunt. True or not, the stinger is certainly smarting more than the stung.

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Kashmir

Unhealed wounds

Nov 28th 2002 | DELHI
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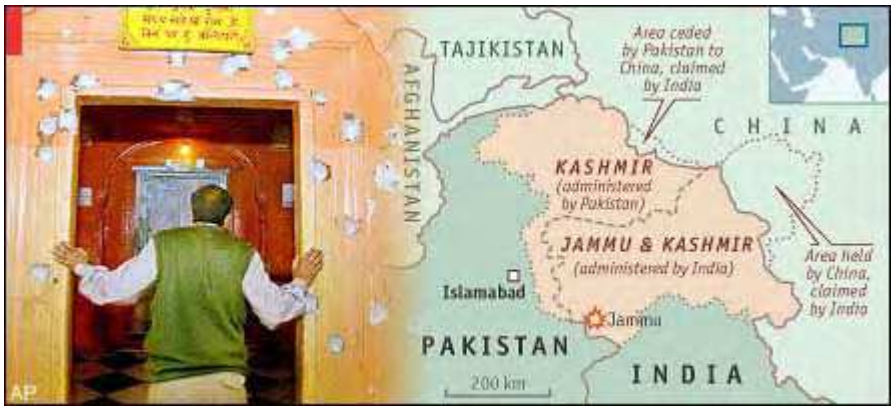

Post-election optimism faces a hail of bullets

Get article background

"A HEALING touch" was the promise held out by the newly-elected government of the Indian state of Jammu and Kashmir. This week, sarcastic Indian commentators harped on the phrase. Three days of murderous terrorism had culminated, on November 24th to 25th, in an assault by gunmen on two Hindu temples in Jammu, the state's winter capital, in which 14 people died. The next day, at least another six were killed in other parts of the state. They join perhaps 30,000-70,000 people who have died during a 14-year-long insurgency against Indian rule. The killings dashed hopes, following the elections in September, of a peaceful lull.

India's government was quick to blame the usual suspects: militant Islamists, trained and backed by Pakistan, which claims Indian-administered Kashmir, with its Muslim majority, as its own. But some Indian spokesmen had a new target too: the healing touchers themselves, and the "encouragement" their soft new approach offers terrorists.

This is unfair. Even Omar Abdullah of the National Conference, the party ousted at the elections, agrees. The new government has not yet done enough to deserve the blame. It is a coalition dominated by the People's Democratic Party (PDP) of the state's new chief minister, Mufti Mohammad Sayeed, and Congress, the main national opposition party.

It has repudiated the heavy-handed—sometimes brutal—security policies of its predecessor. It has also promised change: by not enforcing the harsh provisions of India's Prevention of Terrorism Act; by assimilating Indian special forces into the regular police; and by releasing some detained militants.

Of these, 26 have already been freed, but most are members of local groups. India blamed the attacks on Lashkar-e-Taiba, a Pakistan-based Islamist faction. That points the finger at Pakistan, which, despite repeated promises by its president, General Pervez Musharraf, to stop cross-border terrorism, this month freed Lashkar's founder and leader, Hafiz Mohammad Saeed, from detention. He promptly called for continued armed struggle.

Pakistan condemned the latest outrages, and denied responsibility. Indian officials scoff, convinced that General Musharraf, who has just arranged a cosmetic transfer of power to a "civilian" administration, is a serial breaker of promises. So prospects for talks between India and Pakistan remain remote, as India's ruling coalition, facing a key election on December 12th in the state of Gujarat, seeks to avoid criticism for going "soft" itself.

In Kashmir, however, there is despondency that there is no sign of a dialogue between India and even the moderate Kashmiri opposition. For this reason, Sajjad Lone of the All Party Hurriyat Conference, a coalition of separatist parties that boycotted the elections, condemned the new violence but refused to see it as a setback to peace hopes. In the absence, he said, of any attempt to open a dialogue, there was nothing to set back.

“All we are saying,” says Mr Lone, whose father, a moderate separatist leader, was murdered in May, “is for God's sake talk to somebody, and deliver on the promise made to the international community that the elections were part of a broader peace process.” Each fresh atrocity makes it less likely that India will act on Mr Lone's plea. It also increases the pressure on Mr Sayeed and his Congress partners to drop the healing touch for the heavy hand. That, indeed, is probably the point.

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Taiwan and China

In search of the missing links

Nov 28th 2002 | TAIPEI
From The Economist print edition

On-and-off talks about phones and planes

Get article background

SLOWLY, Taiwan and China have been moving towards an agreement that would establish direct business, communications and transport links between the two countries, ending a ban that dates back to China's Communist revolution of 1949. Or at least they were, until this month. Nothing in the world of China-Taiwan relations is ever easy.

AP

All dressed up and nowhere (Chinese) to go

Hopes for the ending of the ban were kindled a year ago when Taiwan's President Chen Shui-bian asked the country's business and political elite how to get Taiwan's economy, hard hit by the global slump, back on its feet. They overwhelmingly asked for the ban to be lifted. Early in the 1990s, China, an international pariah after the Tiananmen clampdown, had desperately wanted the ban lifted but Taiwan said that, in return, China should recognise its government as one of equal status, and renounce the use of force to resolve differences between the two countries. China said no, and by the end of the decade, now richer and more confident, it no longer needed Taiwan so badly.

Taiwan, though, seeing its American markets in free-fall and challenged by China's technically-skilled and ludicrously cheap workforce, began to woo the Chinese. Chinese officials said that any progress on direct links depended on Taiwan agreeing that it was actually a part of China, a claim that over the years the Taiwanese have parried. In May this year, Mr Chen suggested a “Hong Kong” solution over business links. Although Hong Kong is now Chinese, it has some freedom to negotiate independently. It agreed to direct air links with Taiwan through a deal made by business people representing the airlines of the two territories, renewing an arrangement that existed when Hong Kong was British. Government officials acted only as “advisers”.

At first the Chinese turned down Mr Chen's proposal that the same idea could be applied to direct links with China itself. But in June Qian Qichen, a Chinese vice-premier, spoke favourably of letting business associations negotiate for each side. In mid-October Mr Qian said that recognition of the “one China” principle was no longer a condition for negotiations and that such links would not be judged “domestic”, which would imply that Taiwan was part of China. But Taiwan has changed its mind. Mr Chen now says that there must be government-to-government talks. With Taiwan's economy looking better, Mr Chen is less desperate.

The latest variation on the air-links theme, suggested by opposition MPs, is to allow direct cross-strait charter flights during the Chinese new year, to shorten the journeys of Taiwan businessmen in China

coming home for the holiday. Fine, said Taiwan's government, as long as they are routed through Hong Kong, making them, of course, not direct flights at all. Nevertheless, direct links are still being talked about, and talked about...

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South Korea

Down to the wire

Nov 28th 2002 | SEOUL
From The Economist print edition

The presidential race tightens

THE presidential race in South Korea officially got under way this week, as candidates formally registered for the December 19th election. It increasingly looks as if this will be the tightest in South Korea's (admittedly brief) history of such things.

In the past few days, it has become, to all intents, a two-man contest. One of the contenders is a liberal former human-rights lawyer, Roh Moo-Hyun, who is the candidate of the governing Millennium Democratic Party (MDP), founded by President Kim Dae-jung; the other is Lee Hoi-chang, a former Supreme Court judge, from the conservative opposition Grand National Party.

The race was transformed on November 24th, when a third candidate, a millionaire businessman and soccer chief, Chung Mong-joon, pulled out. His newly-created National Alliance 21 party and the MDP had agreed to put up a joint candidate as the only chance to defeat Mr Lee, who was well ahead in the polls. President Kim, whose five-year term ends in February, is constitutionally barred from standing again. Mr Roh won more support in an opinion poll carried out after a television debate with Mr Chung at the weekend, so Mr Chung duly conceded defeat. Since then, several polls have given Mr Roh a significant lead over Mr Lee, who unsuccessfully stood in the last presidential election in 1997, and who had until this week been considered the clear front-runner.

Unusually for a presidential candidate in technocratic South Korea, Mr Roh did not attend college but became a lawyer specialising in human-rights cases. He says he will reduce the gap between rich and poor and rein in the country's conglomerates, or *chaebol*. Much of his support comes from voters in their 30s and 40s, who are fed up with money politics and scandals. Mr Roh also favours the continuation of Mr Kim's "sunshine policy" of engagement with the North, whereas Mr Lee has called for aid to be halted until the North dismantles its recently-revealed uranium-enrichment programme for nuclear weapons.

As well as the front-runners, there are several candidates from minor parties standing in the poll, for a grand total of seven in all. They include Kwon Young-Ghil of the Democratic Labour Party, who was once jailed for organising a general strike; and a former spy agency chief, Chang Se-Dong.

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Australia

Tough on Muslims

Nov 28th 2002 | SYDNEY
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A worried nation tries to strengthen its security

Get article background

FOR years, Fred Nile, a clergyman-member of the New South Wales parliament, has been fighting a fruitless campaign to ban Sydney's Mardi Gras, Australia's biggest gay event. When Mr Nile called recently for another ban, on Muslim women wearing chador robes, claiming they could be terrorists hiding weapons, most political leaders quickly dismissed the proposal. An exception was John Howard, the prime minister, who said, “I like Fred and...you know Fred speaks for the views of a lot of people.” Mr Howard decided against a ban, but his equivocation provoked a storm of protest from Australia's Muslim leaders, who accused him of fostering religious division.

Islam is Australia's fastest-growing religion. But since the terrorist attacks on America and the Bali bombings in October, in which more than 80 Australians were killed, the country's Muslims have felt under siege. Mosques have been attacked. Women wearing Islamic headscarves have been abused. Phone-in radio shows, where bigotry flourishes, have been flooded with anti-Muslim calls. Some of the conservative government's actions over security have not helped.

Armed with guns and sledgehammers, in late October police and officers from the Australian Security Intelligence Organisation (ASIO), the federal security agency, raided homes of Indonesians living in Sydney, Melbourne and Perth. The government justified the raids as part of an investigation of Muslims suspected of having links to Jemaah Islamiah, a group that Australia has proscribed since the Bali bombings. Some of those raided apparently were chosen because they had attended lectures in Australia by Abu Bakar Basyir, an Islamic cleric who has been questioned in Indonesia about the bombings, but has denied any link to them.

Indonesia protested to Australia over the treatment of its nationals. Mr Howard defended “one hundred per cent what ASIO has done”. Legislation is before the Australian federal Parliament to allow the police and ASIO to detain “people of interest” without charge or legal representation. John Dowd, Australian president of the International Commission of Jurists, says Muslims will be their main targets. So far the only person police have arrested as an alleged terrorist is Jack Roche, of Perth, a white British immigrant and a convert to Islam, who is charged with conspiring to bomb Israeli diplomatic missions in Canberra and Sydney.

Australia has about 280,000 Muslims, more than half of them living in Sydney. The main wave came after the Lebanese civil war broke out in the 1970s, and almost half the Muslim community are now Australian-born. Their presence was hardly an issue until politics and terrorism made it one. Mr Howard and his ministers snatched victory in last year's general election by demonising mainly Afghan and Iraqi boat refugees as a threat to security. Then in August, amid tensions as the first anniversary of September 11th approached, a Lebanese Australian was sentenced to 55 years for a series of rapes.

But since Bali, some people are questioning whether Australia, which previously felt insulated from terrorism, may have invited its own problems through the government's support for American policies. Brian Deegan, of Adelaide, whose 22-year-old son, Joshua, was killed in the Bali bombings, sent an open letter to Mr Howard on November 22nd, seeking answers to Bali and its aftermath: “Was it because we, as a nation, have pursued a role in the United States-led war on terror that we cannot possibly fulfil? Why is your government torturing certain citizens of our country by allowing armed invasions upon their private properties—all in the name of national security?”

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Turkmenistan

“They tried to kill me”

Nov 28th 2002 | ALMATY
From The Economist print edition

Niyazov's story of attack

THE president of the Central Asian state of Turkmenistan, Saparmurad Niyazov, known for his dictatorial rule and bizarre personality cult, claimed to have escaped an attempt on his life on November 25th in the capital, Ashgabat. The president's convoy of cars was said to have been blocked by three vehicles and then sprayed with bullets by gunmen. Mr. Niyazov was unhurt, but several other people were injured, according to a presidential spokesman.

On television, the president said four former government officials, among them Boris Shikhmuradov, who used to be foreign minister, had plotted to kill him. All live in exile and said they knew nothing of a plot. “But Niyazov deserves as many deadly gunshots as lives and destinies he has ruined,” said Mr Shikhmuradov. Sixteen people were said to have been detained. Some were mercenaries, the president said.

Mr Niyazov, who is 62, has been in power in Turkmenistan since Soviet times, and runs the country with Stalin-like ruthlessness. A huge golden statue of the president occupies the centre of Ashgabat on a revolving stand so that it always faces the sun. Some of the months of the year have been renamed after the presidential family.

Plenty of people might have a grudge: life in Turkmenistan gets steadily grimmer. The president has closed the academy of sciences and the country's main opera and ballet theatre. Education is limited to nine years. Most people live in dire poverty although, with extensive gas reserves, the country ought to be rich. This year, Mr Niyazov has sacked dozens of senior officials for abuse of office. Now, he may have something rather more serious to worry about.

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Iraq

The inspectors arrive

Nov 28th 2002
From The Economist print edition

AP

An unenviable task begins

Get article background

ON NOVEMBER 27th, an advance party of 17 inspectors from Unmovic and the IAEA—the two United Nations agencies charged with finding and destroying any weapons of mass destruction that Iraq may have developed—began their detective work. Theirs is a delicate task. They must be cordial to their hosts, but tough in the face of any shenanigans. They need to persuade America that the inspection regime is robust, while at the same time assuring other governments that they are not simply American stooges. They will also be burdened by the knowledge that their findings could unleash a war.

Understandably, Hans Blix, the head of Unmovic, has been sounding tough and conciliatory by turns. In Iraq, he has dangled the prospect of an end to economic sanctions. The inspectors did not immediately use the most intrusive powers that the UN resolution of November 8th affords them, such as unrestricted access to Saddam Hussein's so-called presidential palaces, and the ability to whisk Iraqi sources and their families to other countries to be questioned. They first visited a scientific research centre, a graphite plant, and a missile engine testing facility.

Given the relatively puny resources at the inspectors' disposal—there will eventually be between 80 and 100 of them in Iraq at any one time—this low-key start was unsurprising. It could also help to rebut the view, expressed by the Iraqi foreign minister on November 23rd in a letter to Kofi Annan, the UN secretary-general, that the UN resolution was merely a pretext for war.

Despite this belief, Iraq did not hinder the first inspections. But Iraqi officials have, according to Mr Blix, already begun to argue that presidential sites should be treated differently from common-or-garden factories. The Unmovic and IAEA teams will be prepared for the sort of duplicity and harassment that plagued the last inspection regime, which ended rancorously in 1998. They also know that the Iraqis may have tried to bamboozle them by hiding controversial equipment underground, in cities or on mobile trucks.

The paths to war

For their part, the inspectors are armed with sophisticated kit to detect nuclear and biological activity,

though a more potent tool is likely to be intelligence, ideally from Iraqi whistleblowers. Their biggest asset, though, is the unity of the UN. To preserve it, Mr Blix sounded suitably uncompromising when he addressed the Security Council on November 25th. His personal credentials have been questioned by some close to the Bush administration, which remains sceptical about an inspection process that it feels Iraq is unlikely to honour.

Although it has not pressed the point, America has also argued that, by firing on planes patrolling the “no-fly zones” over the north and south of the country, Iraq may already be in “material breach” of the UN resolution, and therefore liable to the “serious consequences” it stipulates. But the full account of its weapons programmes, which Iraq is obliged to give to the inspectors and the Security Council on or before December 8th, is likely to be Mr Hussein's first big chance to ignite a war. Mr Blix says that if Iraq persists in claiming to have no weapons of mass destruction, it will be obliged to prove this negative. It could take a year for inspections to yield a full and fair picture of Iraq's armoury.

In any case, the discovery of incriminating evidence (in a country around the size of California) is less likely to be a trigger for hostilities than obstruction of the inspectors. Preparations for war have continued, in the form of intense patrolling of the no-fly zones, and a declaration by the leaders of the 19 NATO countries at last week's Prague summit, which promised “effective action” to deal with Iraq. America has also provoked a wrangle at the UN by arguing that some of the commodities Iraq is allowed to import under the oil-for-food programme could have military uses, and ought to be proscribed.

Countries suspected of selling arms to Iraq have also been coming under scrutiny. A new report by the International Crisis Group, a think-tank, details the sale of arms to Iraq by Serbian companies. On November 25th, an Anglo-American report revived the international spat over whether Ukraine had sold radar-detection equipment to Iraq, and whether Leonid Kuchma, Ukraine's president, knew about it. (Mr Kuchma was roundly snubbed when he turned up in Prague.) The investigators who visited Ukraine complained that while some officials co-operated, vital information was withheld. As events in Iraq unfold, that may become a depressingly familiar lament.

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Iran

Revolting against the Revolution

Nov 28th 2002 | TEHRAN
From The Economist print edition

Student protests could spark something bigger. Or they could be squashed

Get article background

WAS it a wobble? It looked this week as though the hardest of the hardliners was indeed wobbling, in the latest confrontation between Iran's conservatives and its reformers. On November 26th, four prime movers behind this month's student protests were arrested, apparently at the behest of the Revolutionary Court, which deals with offences that affect national security. The next morning, they were freed on the orders of the Supreme National Security Council, which contains several conservatives, as well as reformists such as the president, Muhammad Khatami. Some reformists detect signs of division among their opponents.

This impression was reinforced by an apparent conflict between Iran's supreme leader, Ayatollah Ali Khamenei, and Abdulnabi Namazi, the prosecutor-general. Mr Namazi this week ruled out an automatic review of the death sentence on Hashem Aghajari, a free-thinking academic convicted of apostasy for daring to criticise Iran's theocratic system. That sentence, passed three weeks ago, had provoked the student protests. If Mr Aghajari wished to avoid being executed, Mr Namazi said, he would have to appeal, which he has so far refused to do. By contrast, the supreme leader had earlier tried to defuse the row by ordering a review of the sentence, appeal or no appeal.

It had seemed as though a truce was in place, after the demonstrations that had climaxed, on November 12th, in a day of mostly peaceful strikes and protests on campuses. After Mr Khamenei's intervention, Mr Khatami's government obligingly withdrew its support for the demonstrations. Student activists, understanding that the police would no longer protect them from bullies hovering on the sidelines, halted their open-air protests.

The student leaders will soon be in court. Akbar Attri, one of them, expects to be charged with “acting against national security”. Three other reformists were arrested shortly before Mr Aghajari received his death sentence, and have apparently been denied access to lawyers.

Parliament is currently discussing two bills, tabled by the president, that seek to break the power of the establishment below Mr Khamenei. The president knows that, were he to retract the bills, Mr Aghajari and other reformists facing trial would be the first to benefit. But Mr Khatami, his allies say, is standing firm. According to these allies, if the bills are ratified by parliament and then, as seems likely, rejected by a conservative upper house, the reformist-dominated parliament will call a referendum on the kind of government Iranians want. That would bring them head to head with Mr Khamenei, whose approval is needed for the staging of a referendum.

It may never happen. One conservative newspaper, which often prints news before it occurs, has hinted at a coming onslaught against reformist parliamentarians. The bullies who beat down student protests in 1999 are on the streets again. The deputy head of the Revolutionary Guard has said the *basij* militia will not hesitate to “enter the scene” in the face of “domestic threats that attack the essence of the system”.

Mr Khamenei and other conservatives have made it clear that they regard Mr Attri and his colleagues as such a threat. Though they are few in number, the student activists are in the vanguard of a movement to reject not only religious dictatorship, but also the “religious democracy” that Mr Khatami has struggled ineffectively to install. Mr Attri wants to start a campaign of civil disobedience.

For the moment, dissidents like Mr Attri are being defended even by moderate reformists. Will that enable the students to lead a wider revolt, now that they have staged the most widespread protests seen

in Iran for years? Probably not. Most Iranians, whatever their dissatisfaction with the status quo, are loth to get involved. As Iran's struggle approaches its conclusion, they just want to be out of the firing line.

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Riots in Nigeria

Beauty and the beastliness

Nov 28th 2002 | KADUNA
From The Economist print edition

Miss World was not to blame

AP

WITH a bullet in his arm and jeans drenched in blood, Kamil Lawal lies motionless in a hospital bed. Around him are dozens of badly injured men and women, casualties of the riots that battered the northern city of Kaduna last week. At least 220 people died, more than 1,000 were injured, and 11,000 lost their homes, all because of Miss World.

At least, that is how the mayhem has been portrayed. Some Muslims were indeed outraged that the world's favourite beauty contest was due to take place in Nigeria during the holy month of Ramadan. *This Day*, a Nigerian newspaper, inflamed matters by deriding Muslim opposition to the pageant and suggesting that the Prophet Muhammad, had he been alive, might have married one of the beauty queens himself.

News of this alleged blasphemy spread fast, by word of mouth and via text messages. Imams raged, and protesters torched *This Day*'s office in Kaduna. For the next four days, mobs of young Muslims ran amok, burning down churches, bars and brothels, smashing crates of beer in the streets, and killing their Christian neighbours. Christians responded by burning mosques and killing Muslims. Miss World was moved to London, and the beauties fled, doubtless regretting that they had not packed enough winter clothes.

Some western commentators tut-tutted that the pageant's organisers should never have tried to stage such an immodest spectacle in such a conservative country. This is unfair. Beauty contests have been popular in Nigeria for decades. Every year, young women from all over the country, including many Muslims, vie for titles such as Miss Nigeria, QueenAfrik, and The Most Beautiful Girl in Nigeria. Such pageants rarely spark riots.

But Kaduna is unusually fissile. Its population is evenly divided between Muslims and Christians, who fight often and hard. Two years ago, when Kaduna state followed other northern Nigerian states (which are mainly Muslim) and introduced *sharia* criminal law, 2,000 people died in street battles.

Kaduna's governor, Ahmed Muhammad Makarfi, is Muslim, but his more fiery co-religionists think he is too soft on Christians. He fails to enforce *sharia*, they say: alcohol is still openly sold in Kaduna. What is more, he supports Nigeria's president, Olusegun Obasanjo, the first southern Christian head of state for years. The rioters tore down Mr Makarfi's campaign billboards (there are elections next year), looted a shopping centre he is rumoured to own and called for his head.

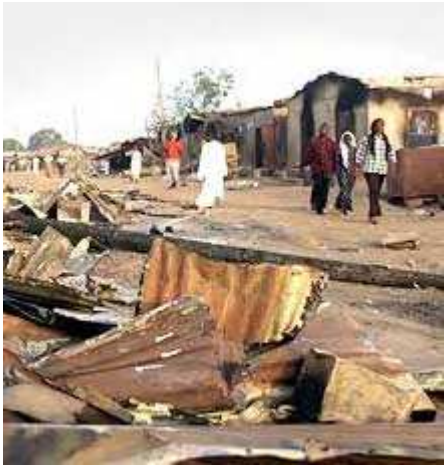
Factions within the ruling party (to which Mr Makarfi belongs) may have used the riots as an excuse to thump each other. Political office is lucrative in Nigeria, not only for the office-holder, but also for his kith and kin. Mr Makarfi has been criticised for the way he awards public-works contracts, and for having spent millions moving two state universities to his home town. Power without accountability is worth fighting for.

The riots might have been less lethal if the security forces were more competent. But many of the injured say they were shot by the police. Mr Lawal, for example, says he was shopping when the police mistook him for a rioter and opened fire.

Since 1999, when Mr Obasanjo came to power, 10,000 Nigerians have

died in ethnic and religious violence. He blamed the latest carnage on the press. The editor of the offending issue of *This Day* was arrested by the secret police. The author of the offending article, a female fashion writer, resigned and fled the country. The governor of Zamfara, another northern state, issued a *fatwa* calling for her to be killed. Mr Obasanjo's information minister accused the foreign media of conspiring “to show that Nigeria is incapable of hosting an event like Miss World”.

AP



Careless words cost lives

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AIDS

Forty million orphans

Nov 28th 2002 | WINDHOEK
From The Economist print edition

How AIDS will disrupt African society

Get article background

JUST as the bubonic plague overturned the social order in medieval Europe, AIDS will reshape Africa. But how? This week, as the UN released horrifying new figures for the global epidemic (see article), representatives of 22 governments sat down with experts in Windhoek, the Namibian capital, to discuss scenarios.

The outlook is unimaginably grim. Of the 42m people infected with HIV, the virus that causes AIDS, three-quarters live in Africa. In some southern African countries, more than a third of adults carry the virus, a rate once thought impossible. A 15-year-old boy in Botswana has an 80% chance of dying of AIDS.

Among the many ways that this is destabilising the continent, perhaps the most worrying is the exploding population of orphans. Those who die of AIDS often leave children behind, most of whom are not infected. Counting all those under 15 years old who have lost at least one parent, Africa already had 34m orphans last year. By the end of the decade, that is predicted to rise to 42m, half orphaned by AIDS.

A huge number of children without parental guidance is likely to spell trouble. Orphans are far more likely than other children to miss school, turn to begging or prostitution, fall sick, fail to be inoculated, pass on diseases, and die young. In Mozambique, 68% of children with both parents alive attend school, compared with only 24% of those with no parents.

Orphans are often disruptive. In Latin America in the 1980s, street children drove up crime rates and were both the perpetrators and the victims of horrendous violence. Africa's orphans are far more numerous. Crowds of them congregate at traffic lights in Nairobi, Lusaka and Johannesburg, begging, sniffing glue and pilfering. Many are traumatised, having watched their parents slowly waste away and die. Most are shunned because of the stigma surrounding death by AIDS and the assumption that they carry the virus too.

Such children slip easily into delinquency. In ten years' time, the UN estimates that one-third of South African 18-year-olds will have no mother. Doug Webb of Save the Children, a global charity, predicts “mass psychological problems”. Others link South Africa's high incidence of rape, especially of children, to the large numbers of men brought up in broken families in the 1970s and 1980s. If this is true, things can only get worse.

In the rest of Africa, the big worry is orphans with guns. They are “putty in the hands of warlords”, says Hamish Young of UNICEF. Abandoned children know their lives are likely to be short, so they figure they may as well seek thrills while they can. Gangs or rebel armies can provide substitute families, while orphans can make attractively nihilistic recruits. Children as young as five fought in civil wars in Sierra Leone, Liberia, Congo and Uganda, and have been responsible for many of the worst atrocities. Some observers think AIDS is partly to blame for the mayhem in Zimbabwe: the country has a million orphans and many more young men who expect to die young, easy recruits for land-grabbing militias.

What can be done? Extended families do a heroic job of caring for orphans and preventing delinquency. Typically, a grandmother takes on children after her daughter dies. Where governments can afford to help, as in South Africa, Namibia and Botswana, bigger pensions and foster grants can keep families together.

No parents, no grandparents either

But as today's grandparents die of old age, and the middle generation succumbs to AIDS, there will be fewer people to care for future orphans. Carol Bellamy, the head of UNICEF, says that AIDS and hunger have already placed an unbearable strain on over-extended families in southern Africa. She predicts “an entirely disaffected, angry generation of children”.

Many children are left looking after their even younger siblings. Child-headed households are becoming common. They need help. But few African governments are prepared to give grants to minors; many do not even allow them to inherit property. Nor are they keen on building day-care centres or orphanages, even cheap village ones.

Is there any hope? Much more could be done to keep infected parents alive. If cheap anti-retroviral drugs were widely and safely distributed and better food and nursing care made available, mothers and fathers could expect to live for several more years. Children would of course rather stay at home than go to granny or join a gang. But without massive foreign aid, Africa cannot afford much in the way of drugs, food or nursing.

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Austria's general election

The revival of the mainstream right

Nov 28th 2002 | VIENNA
From The Economist print edition

AP

How has a far-right populist in Austria been marginalised? In this article and three others we look at countries where immigration has become controversial

FOR 16 years, Jörg Haider, a far-right populist, had been siphoning votes away from Austria's two main parties, the Social Democrats on the centre-left and the People's Party on the centre-right, turning his Freedom Party from a midget into Austria's heftiest party after the Social Democrats. No more. In a general election on November 24th, the Freedomites plunged from their record 27% of votes cast last time, in 1999, to just over 10%. The People's Party led by Austria's incumbent chancellor, Wolfgang Schüssel (pictured above), who, amid much initial rancour, had been governing in tandem with the Freedom Party, has turned from prey into predator.

A whisker behind Mr Haider's lot in 1999, Mr Schüssel's party jumped into first place for the first time since 1966, with 42% of the vote. But with 79 of parliament's 183 seats, his People's Party still needs a coalition partner. Who will it be? Could Mr Schüssel rule with a minority in parliament? How much did the politics of immigration affect the election result? And is Mr Haider out of the picture for good?

Despite his poor showing, Mr Haider may be around for some time yet. A day after the election, he said he would resign as party leader but changed his mind overnight. Since then, he has threatened to purge his party of many of his critics, including Karl-Heinz Grasser, the outgoing coalition's popular finance minister, to whom Mr Schüssel has promised the same job in a new government. Confusingly, Mr Haider then withdrew his expulsion threat. In any case, with the maverick populist still in charge of an albeit diminished party, Mr Schüssel will think twice before renewing a deal with it.

With which other lot, then? On paper, the Greens, whose vote went up a shade to 9%, might fit the bill. But they have firmly ruled out a deal; many of them cannot forgive Mr Schüssel for his previous dalliance with Mr Haider.

That leaves the Social Democrats, led by Alfred Gusenauer. Their vote went up from 33% to 37%. They have often shared government with the People's Party before. Austria's president, Thomas Klestil, is already calling for another such “grand coalition”. But the mood among Social Democrats is against, especially as they would be the junior partner in the marriage.

So a minority government led by Mr Schüssel cannot be ruled out. That, think some Viennese pundits, could lead to chaos—and another election soon. But others point out that several Nordic countries have

recently been governed, quite satisfactorily, by minority governments.

Moreover, the Social Democrats demand for higher social spending is just what makes Mr Schüssel and Austria's majority of voters on the right most queasy. Indeed, one reason for the People's Party victory in Austria was the recent dismal economic performance of neighbouring Germany's "red-Green" coalition.

So Mr Schüssel is all but certain to stay in power. On the whole, he has won fulsome plaudits for his adept handling of Mr Haider. Mr Schüssel knew he was taking a risk when, amid a storm of international criticism, he first embraced Mr Haider's party in a coalition. Then he managed to persuade its more sensible members to eschew the nastier parts of their credo, while himself adopting some of its more reasonable policies, such as faster privatisation and trimming the state sector.

As Mr Haider saw leading figures in his party being sucked into the more respectable right-wing establishment, he found himself isolated. In a bid to restore his party's credentials as an anti-establishment protest movement, its maverick leader reverted to extreme rhetoric and behaviour—making yet another friendly visit, for example, to Iraq's Saddam Hussein. The upshot was that many Austrians who had voted for Mr Haider were lured back to the mainstream parties, especially to Mr Schüssel's.

Xenophobia muzzled

As for immigration policy, the inclusion of the Freedom Party in government for the past three years has made only a slight difference. The lot of newcomers cannot be said to have got bleaker, despite fears that it would. They now have to undergo compulsory German-language lessons. Quotas for immigrants have got marginally smaller. And, more recently, welfare for asylum-seekers from places such as Kosovo that can no longer be deemed zones of conflict has been reduced. But Austria has not become notably harsher in its treatment of immigrants than it was before the Freedom Party joined the government. Strikingly, immigration was very much less of an issue than in previous elections.

Pollsters suggest that the bilateral political sanctions imposed against Austria by its 14 fellow European Union countries after the right-wing coalition was formed in 2000 were counter-productive. The new government's ratings stayed high, thanks to an enhanced feeling of national solidarity. After the sanctions were lifted, Mr Schüssel and his supporters felt vindicated. With Mr Haider personally kept out of national power in Vienna and restricted to his governorship of the southern province of Carinthia, he was increasingly reduced to the margin.

Yet the Freedom Party, supported as much for its anti-establishment flavour as for Mr Haider's xenophobia, continued to stay above 20% in the opinion polls during and after the country's ostracisation. It was only this August, when Mr Haider started to fight within his party and revert to rabble-rousing, that its support dived.

He then embarrassed his own party's new figurehead leader, Mathias Reichhold, by appointing extremists to key posts in the party and by flying off to Baghdad. When Mr Reichhold fell ill, an old Haider loyalist, Herbert Haupt, took over in October. But by then, Mr Haider's renewed verbal attacks—against foreigners, the EU and Mr Schüssel himself—no longer made sense to so many Austrians. For many of them, he had turned from hero into fool.

In sum, it was Mr Schüssel's skilful manipulation and attention to some of the more reasonable of the Freedom Party's causes, rather than immigration policy or scolding from Brussels that brought Mr Haider down. As a result, Austria's mainstream, respectable right has acquired a rare, if perhaps short-lived, ascendancy.

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Denmark's politics

A tale of two Rasmussens

Nov 28th 2002 | COPENHAGEN
From The Economist print edition

One lost the election, the other came out on top and is still there

A YEAR ago he crushed the Social Democrats in a general election. Today, Anders Fogh Rasmussen is still riding high in the opinion polls, and the opposition is still in disarray. And critics who thought their new Liberal prime minister's lack of international experience would damage Denmark's stint in the EU presidency have been proved wrong.

Mr Fogh Rasmussen has positively blossomed in Brussels. At an EU meeting this month to strike a deal on travel permits for residents of Russia's Kaliningrad enclave, he handled the press conference with aplomb. “Ladies and gentlemen, we have a deal,” he said before holding the crowd for a theatrical pause, flashing his handsome smile, and adding “Again”. At home, says one poll, two-thirds of voters think he is doing a good job; nearly as many expect him to win again in 2005.

This level of approval, a rare thing in Danish politics, has two main causes. One is a perception that he has fulfilled his election promises. For instance, egged on by an anti-immigration party whose support his minority government needs in parliament, he said he would reduce the number of foreigners getting into Denmark. A year on, asylum applications have plunged by 71%. He has also kept promises to freeze taxes, cut foreign aid and fire civil servants. Though most voters believe he has failed to fulfil a pledge to improve health care and pensioners' welfare, this does not spoil the overall impression of success.

His second strength is an ability to avoid the fall-out of scandal or incompetence. There has been a good deal. In the past few weeks alone, the finance minister was accused of collecting unjustified EU farm subsidies for himself (he repaid the cash) and the justice minister admitted to bungling extradition procedures aimed at a Chechen separatist. But none of the dirt stuck to the prime minister.

Meanwhile, his opponents are up the Kattegat without a paddle. The other Rasmussen, Poul Nyrup Rasmussen, the beaten Social Democratic prime minister, has spent a year failing to revitalise his party after its election rout. He recently admitted defeat—and gave up the party leadership. But to whom? He has given only lukewarm support to Mogens Lykketoft, his former finance and foreign minister, who has bid for the job; young blood is needed, says the ex-prime minister. Next month's special congress to pick a new leader may end in a bloodbath instead.

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A Swiss referendum on immigration

A country divided

Nov 28th 2002 | GENEVA
From The Economist print edition

The Swiss are split in half over asylum-seekers

FEARS of being “swamped” by foreigners have long been part of neutral and now prosperous Switzerland's psyche. In the second world war the country's authorities turned back Jewish refugees for a period of several months at the height of the Holocaust. Despite official apologies, the Swiss are reminded of that sorry episode whenever the subject of refugees or immigrants is brought up abroad. A fifth of the Swiss population is now foreign.

In the 1970s and again in 2000, voters rejected proposals by right-wingers seeking to limit immigration, largely from Italy. In 1996, 54% of them turned down another proposal put to a referendum, to tighten curbs against illegal entry. Three years later, amid a record number of arrivals, mainly from Kosovo, the right-wing Swiss People's Party, whose leading light is Christoph Blocher, launched a similar initiative. Three years on, Swiss voters have probably stymied that proposal, to curb the number of asylum-seekers. The four-party government coalition, which includes a moderate from the People's Party, hopes that the voters have avoided the deluge of criticism that would have come down on the Swiss from abroad if they had said yes.

Or have they avoided it? It was the closest call in a Swiss referendum since 1891. Less than 50.1% said no, barely 3,000 more than those who are fed up with asylum-seekers. But in one canton some ballots are being recounted, so the overall outcome is still uncertain.

Under the People's Party initiative, any asylum-seeker who arrived at the Swiss border after passing through a “safe” third country, which could also have provided asylum, would have been turned back. This would have shut out most would-be refugees arriving overland via Austria, France, Germany or Italy. Last year some 12% of asylum applications were accepted.

The referendum result boosts the People's Party's chances in the general election due in a year's time. Before the referendum, its support in opinion polls had climbed from nearly 23%, the figure it got in the last general election, in 1999, to about 25%. This makes it Switzerland's most popular party. But its support is concentrated in the German-speaking cantons in the country's north and east. None of the French- or Italian-speaking cantons approved of the proposition.

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Immigrants in the Netherlands

Fortuynism without Fortuyn

Nov 28th 2002 | ROTTERDAM
From The Economist print edition

The populist politician is dead. But not his ideas

THE young man was angry. The real trouble, he said, was the downfall of the unemployed young, white, Dutch male. There aren't in fact many of them, and the liberal, middle-class audience among whom he sat at this conference on the rise of the far right was minded to jeer. He burst out: “None of you lives in a ghetto.” It was the most telling thing said that evening.

Walk west from Rotterdam's Kruisplein and you'll see why. In two kilometres of down-market shopping street, one face in two or three is white. Cross the canal into Spangen, a district that still voted 39% for Labour in the March local elections when, city-wide, that long-dominant party was routed by an almost ad hoc group called Liveable Rotterdam (LR), led by Pim Fortuyn. A primary school is coming out. Hardly one of the children is white. “You see what we're on about?” says an LR man.

Fortuyn is dead, murdered just before the Dutch general election in May. The totally ad hoc national “party” he had put together for the election is in utter disarray. Its vote, 17% in May, is now almost invisible to pollsters. The three-party cabinet that it joined, as the number two force, collapsed last month. After the new election, on January 22nd, its partners, the Christian Democrats and Liberals, may well form a government on their own. But Fortuynism is not dead: these two parties have taken it aboard; so, if less so, has Labour, the big loser in May. The campaign will be about “security” (ie, crime), immigration and integration—for many voters, all one issue.

An ugly campaign it may be. But at last the old parties have noticed what Fortuyn did: that immigration and its effect on the fabric of society are real issues that do not go away just because the elite chooses not to mention them. Fortuyn, in fact, was not on about race, but culture, specifically that of the Muslim Turks and Moroccans who (with people from the Dutch Antilles, Surinamese and some West Africans) make up 6% of the population. But race is visible, and in Rotterdam the figure is 30%, not 6%.

Facing up to reality, at last

If the newcomers' integration, or lack of it, into Dutch society that Fortuyn talked of were the only problem, it would be hard enough. But just as visible is crime. Any Dutch voter will tell you about it; many associate it with immigrants; and they are not wholly wrong, as even newcomers' defenders admit. Of 250-odd people jailed last year for street crimes in central Rotterdam, 80% were from ethnic minorities.

Minority is a catch-all term. The Turks have a better reputation than others. One LR councillor would like all illegal entrants packed off home, but would turn a “blind eye to those who work.” For example? Turks, he says, generally do so, but too many Moroccans live off drugs. “Turks are more modern, more educated, more adaptable than Moroccans. They're the next group that will integrate,” says a reporter in Rotterdam.

Indeed, the big crime worry there now is about neither Moroccans nor Turks but the (non-Muslim) Antilleans. Nor is fear of crime a one-party or one-skin-colour affair. Rotterdam's town-hall weekly newsletter recently asked four councillors what changes they would most like to see. Three put security first. Two were LR; one was a Labour man—and, ethnically, a Turk.

What is to be done? The outgoing government, with a Fortuynist minister, Hilbrand Nawijn, in charge of immigration and integration, set out, with some success, to close the doors, especially against asylum-seekers. But Mr Nawijn also studied ways to stop, notably, Moroccans bringing in new wives or husbands

from their villages. He even took a look at depriving some Moroccan, but Dutch-citizen, criminals of their citizenship, so they could be deported; unconstitutional, he was told.

As to integration, new arrivals were already required to take courses in language and citizenship—1,000 hours, within a year. On top, Mr Nawijn proposed to charge *euro*6,000 ($5,940), half refundable if the newcomer completes the course.

In Rotterdam, run by a “cabinet” that includes three from LR, two Liberals and two Christian Democrats, the big priority is security. But integration is number two. One aim is by 2006 to get 50% of “immigrant” children into kindergarten and to improve their language skills up through school. For adult newcomers, the aim is to get 95% to do citizenship courses while halving the 30% drop-out rate. And so on. It may not happen, but the push is genuine: LR, with 16 seats out of 45, was sensibly run by Fortuyn after its March success, and even critics admit it lives in the real world.

How to embrace them

Another drive is on housing. Nearly all the city's land is council-owned; 80% of its dwellings are rented, many from ex-council housing associations. So if you want to move upmarket and buy your own place, you have to move to the suburbs. Result: one-class poor areas, which means one-race areas like Spangen or the solidly immigrant district near the Feyenoord football ground. So the council now plans to sell land, to encourage middle-class building and restore the social, and racial, mix.

And private initiatives? Nationwide, immigrant groups are gloomy about the trends. The twin towers attack had a sharp effect, putting all Muslims under suspicion. When a poll showed half could “understand” the attack, public opinion (falsely, as the poll also showed) turned that into “sympathise with”. In reaction, some Muslims feel they may as well be hung for a sheep as a lamb, “if we're going to be rejected anyway, however hard we try to be Dutch.” More Muslim women than before now wear headscarves.

The good news is that wise Muslims, while resenting the new suspicions and media distortion, recognise they face real issues: the high rate of immigrant crime is a fact, not just a racist invention; poor command of Dutch or poor education are true barriers.

Muslim society is under its own stress: paternal authority has weakened, while Muslim mothers are eager for their daughters to have the chances they themselves did not. The girls (boys less so) are starting to do well in education. A minority of the young go to the 37 Islamic schools, state-financed, in the Dutch tradition.

Nor are these schools hives of separatism; most are just the opposite, said a recent official report. Nor, by and large, are the mosques, conservative as some are and unwise the odd imam, like the one whose comparison of gays with pigs, in the pigs' favour, set off Fortuyn's notorious attack on “backward” Islam. Tensions are indeed “worse than they've ever been”, says one pro-immigrant. But it is not just virtuous bodies like one called Islam and Citizenship that are trying to ensure those two words go together; so far, at least, it is the mass of Muslims.

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Germany's trade unions

Why so happy?

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With unemployment high and business ailing, only the trade unions seem smug

TRADE-UNION membership in Germany, as in the rest of Europe, is shrinking. Barely one German worker in five now signs up. How odd, then, that trade-union influence has rarely been so strong. Last summer, when the election looked lost for Gerhard Schröder, the unions belatedly swung their still quite heavy weight behind him. With victory for the Social Democrats clinched by just 6,000 votes, it made all the difference. Now, it seems, it is pay-back time. And Germany's chance of reform may dwindle.

Unlike their counterparts in such countries as France, Germany's unions do not usually mount blockades or seek to bring the country to its knees to make themselves heard. They make their presence felt in other ways: in works councils and on companies' supervisory boards; in regional and national bodies that do collective bargaining; and in government-appointed commissions where their views are sought on a range of policies, from pensions and immigration to labour-market and welfare reform. All German governments, of whatever hue, pay attention. But their influence is now so great that they have begun to be regarded as a kind of shadow government.

The proposals for labour-market reform put forward in the summer at the government's suggestion by Peter Hartz, a senior Volkswagen man, are a test of the new government's determination to enact painful structural reforms. “If there is any opposition,” Mr Schröder declared, “it will be broken.” But, under union pressure, they have already begun to be watered down. Job-seekers taken on by the new state-run agencies for temporary workers are now to be paid at the full union rate, instead of some 30% less, as recommended by the commission. Even Mr Hartz has admitted that the reforms as they now stand are unlikely to create anything like the 2m jobs he had originally hoped for.

So why doesn't the government simply stand up to the unions? The main reason is that so many Social Democrats are themselves unionists. Of the party's 251 members of the new Bundestag, the lower house of parliament, three-quarters are union officials or members. Three former union officials are junior ministers in the new super-ministries of economics and employment and of health and social welfare, both of which hold keys to reform. Another is Mr Schröder's chief adviser on health and welfare. None of this bodes well for Germany. Its unions may be more moderate than most, but they are hardly known for their reforming zeal.

Since the election, Mr Schröder has shifted markedly to the left. Even some of the government's own backbenchers are beginning to despair. Its ratings have plummeted. Some pollsters now put the Social Democrats 22 percentage points behind the Christian Democrats. Mr Schröder's popularity has taken a dive, while a song accusing him of fleecing gullible voters by raising taxes is top of the pops. In the midst of the gloom, only the unions seem happy. “The government is on the right path”, says Michael Sommer, leader of Germany's DGB, the main union federation. “Germany is now on the way to being modernised in a socially just way.” Tell that to the country's businessmen—or the 4m-plus Germans without a job.

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France's trade unions

Can they be outmanoeuvred?

Nov 28th 2002 | PARIS
From The Economist print edition

France's government may be moving astutely to outwit the trade unions

Reuters

It's the marching season in Paris

THE season of discontent in France is under way. Last week the farmers were blocking supermarket depots; this week, first the lorry-drivers blocked the roads and then the public-sector workers by the tens of thousands either marched through the streets of Paris and other large cities or simply stayed at home. Meanwhile, youngsters hoping to risk their lives on France's roads are having to be patient: the country's driving-examiners have been on strike for more than a month.

So how is the centre-right government of Jean-Pierre Raffarin weathering the storm? The immediate answer is rather well. The farm unions were quickly mollified by words of ministerial sympathy and by government pressure on the supermarkets to sign an agreement with the farm unions condemning “abusive commercial practices”. By contrast, the lorry-drivers, demanding a rise in pay and an extra month's bonus, were forced into an early, dispirited surrender, both because the forces of the law threatened to seize their licences and because some smaller unions made a deal with the bosses.

The question is whether the “Raffarin method” of sweet words and firm action will work as well with the public sector as with the private. The demonstrations on November 26th, with around 60,000 workers in the streets of Paris alone, were impressively large, and the strike by air-traffic controllers and Air France personnel grounded most flights for the day. Nor is such muscle-flexing over: on December 8th, for example, the teachers' and students' unions are planning to strike.

The reasons for the public-sector strife are several. The unions, especially the Communist-dominated CGT, are anxious to appear relevant after the humiliation of the left in this year's presidential and general elections. This relevance must be demonstrated before elections to the country's labour tribunals on December 11th.

But the biggest reason is the threat to the perks that no public-sector worker will easily give up, notably early retirement (at 55 in many cases), virtually impregnable job-security, and generous pensions. The threat is real enough: first, because a government which needs to restrain public spending will over time have to privatise large chunks of state holdings, not just in Air France and France Télécom but also in sacred cows such as the electricity and gas monopolies; and second, because an ageing population makes pension reform inevitable. So, for example, public-sector workers, who now retire after 37.5 years of contributions, should have to match the 40 years worked in private firms.

None of this is new. But what haunts the present government is the memory of 1995, when the reform-minded conservative government of Alain Juppé took on the demonstrating workers—and lost. Mr Raffarin's tactics are to play for time, promising to tackle pension reform next spring. Critics may argue that time is not on his side, but the counter-argument is that the delay gives Mr Raffarin, a good communicator, a chance to get the public on his side. Given that over half of France's households have a member on the public payroll, that may not be a bad idea.

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Charlemagne

Euroland frays at the edges

Nov 28th 2002
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The biggest test of Europe's single currency so far has come in Portugal

THERE'S no denying it, European integration is damn convenient. Flying into Portugal from Belgium now involves no more hassle than the hop from Chicago to New York. No need to show a passport and—thanks to the euro—no need for the traveller to change money or grapple with baffling prices.

Whether monetary union is proving such a boon for the Portuguese themselves is less clear. Portugal has just suffered a one-day general strike by public-sector workers protesting against an austerity drive, as the government struggles to obey the euro-area's tough rules on public spending. The walls of Lisbon are plastered with posters advertising another strike in December. The armed forces' head has been sacked for moaning about budget cuts. Consumer confidence is plunging. And this is just the start: Portugal has a lot more austerity in store if it is to squeeze its budget deficit down to no more than 3% of GDP, the maximum prescribed by the European Union's "stability and growth pact". This week the European Commission proposed some modest changes to let more solvent countries be less zealous in pursuit of a balanced budget—but the 3% limit, it said, must stay in force.

Few people in Portugal are yet blaming the EU for their tough times. The economic convergence programmes for joining the euro at first gave business a big boost. But now the Portuguese are discovering that euro-membership is a double-sided coin. Joining the single currency means adopting what a Chinese Communist might call "the three inflexibilities": an interest rate that cannot be varied to match the conditions of the national economy; an exchange rate that is similarly fixed; and the strict fiscal rules of the stability pact. Throughout much of the 1990s, all three aspects of the euro helped Portugal. In preparation for the monetary union that took place in 1999, interest rates plunged from over 20% at the beginning of that decade to less than 4% today. Suddenly ordinary people could afford to borrow. New televisions, new cars and new houses were snapped up. The government joined in the consumption binge. The cost of servicing Portugal's national debt fell sharply along with interest rates; the spare cash helped expand the welfare state and give civil servants generous pay rises every year.

As the Portuguese borrowed more and more from abroad, a huge current-account deficit opened up. By 2000 this had reached 10% of GDP. If the old escudo had still been around, Portugal might have faced a run on its currency or sharply higher borrowing costs. But membership of the euro protected the country from storms in the financial markets. Manuela Ferreira Leite, its finance minister, says bluntly: "If it hadn't been for the euro, the IMF would have been in here by now."

Turmoil in little Portugal is one thing, but will other euro-zone countries fall prey to the same problems?

But the three inflexibilities are now hurting. Portugal's economy is slowing—and may already be in recession. All three main routes to renewed growth—private demand, public spending and exports—are constrained by euro-membership. Having taken advantage of euroland's low interest rates to borrow to the hilt, consumers can borrow no more: there is no growth to be had from that source. The government is similarly constrained. It ran up a budget deficit of 4.1% in 2001, and the commission in Brussels thinks it will cross the 3% line again this year. In an effort to avoid the huge fines that might, under the pact's rules, result if excessive deficits continue for two more years, the government is slashing spending, slowing the economy more. In previous troughs, Portugal devalued its currency and exported its way out of trouble. But euro-members cannot devalue unilaterally.

As the economy slows, Portugal's problems may worsen. Slower growth means less tax revenue, which means a bigger budget deficit, which means more spending cuts. "The only way out", says Miguel Namorado Rosa of the Banco Comercial Portugues, "is structural reform—the sort we've been talking about for decades." But that could mean a frightening jump in Portugal's traditionally low rate of

unemployment. Mr Namorado Rosa is not alone in predicting political and social turbulence.

Turmoil in little Portugal is one thing, but will other euro-zone countries fall prey to the same problems? Some Eurocrats in Brussels think Greece may be the next Portugal. The Greeks are enjoying a delightful consumer boom following a collapse in interest rates. But commission officials worry that the Greeks, like the Portuguese before them, are mistaking a one-off gain from falling interest-rates for a long-term increase in wealth. In an echo of what happened in Portugal, the European authorities have ordered the Greeks to take another look at their misleadingly optimistic budget figures. “What we are writing about Portugal today, we will be writing about Greece in two years' time,” says one official.

Many economists predicted that small and peripheral economies would experience the bumpiest transition to the euro zone. But the big euro countries are in trouble too. This month Germany, predicted to have a deficit of 3.8% this year, became the second euro-zone country after Portugal to fall foul of the European Commission's “excessive deficit procedure”. The commission has warned France that next year it risks exceeding 3% too.

One size fits all?

The German and the French cases are in some ways reminiscent of Portugal's. Germany's slow growth may be partly due to the euro area's common interest rate: too low for Portugal but too high for Germany. Both the French and German governments have also been hit by falling tax revenue. And both are suffering labour unrest after merely hinting at painful structural reforms.

The big difference is that they are big countries—big enough, perhaps, to force the rest of the EU to change the single-currency rules. Hence this week's modest changes. But the 3% deficit limit is still in place. And a single interest rate and a fixed exchange rate are inherent in a single currency. Portugal, Germany and the others must just learn to abide by the rules. Mustn't they?

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Firemen

How to run a fire service

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Reuters

The real question about Britain's fire service is not pay, but who should provide it

CAN you put a price on heroism? Yes—and you can manage it sensibly or wastefully too. Britain's firemen's strike is highlighting not only the hose-wielders' remarkably cushy working hours, but also the sharply different ways that other countries arrange things.

Fire costs (which include losses, the cost of fire service, insurance administration etc) are about 1% of GDP in most advanced countries. Within that, there are wide variations, which reflect differences in climate, sense and money. Cold countries like Norway (where direct fire costs are 0.3% of GDP) suffer more from fires than hot ones like Australia (0.16%), because there are more heaters, boilers and so on to go wrong. Strip that factor out, and the next main determinant is building standards (fire doors, sprinklers and so on). After that comes individual choice and common sense on fire safety (not smoking in bed, frying potatoes sensibly).

Only then comes the standard of the fire service. Here, spending a lot of money clearly makes a difference. Japan spends a whopping 0.33% of GDP on its fire service, but in return has extraordinarily low rates of damage from fire. Its fire service is backed up with a league of—oddly—female volunteer fire wardens. This makes sense, given the seismic risk. The Kobe earthquake in 1995 caused 150 fires, and cost 4,000 lives.

The first big question about organising a fire service is how far it should be professional. In continental Europe, especially Germany and Austria, firemen are mostly volunteers outside the big cities. There is a lot of prestige (men like the uniforms and the whiff of bravery). Money is raised locally, with enthusiasm. Austria boasts an astonishing 317,744 volunteer firemen—more than 5% of the adult population.

Volunteer fire brigades are unlikely to have the training to deal with big or complicated fires. But they don't need to. House fires in residential areas are the commonest problem—and one where a handy way with a hose matters more than cutting-edge professionalism.

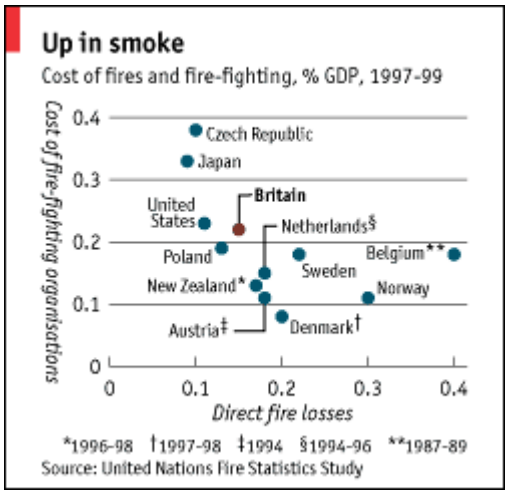
The second issue is what they should do. France's *pompiers*, for example, are also the ambulance and first aid service. By contrast Britain's firemen, notoriously, have in past decades for the most part stubbornly refused training in such medical skills as administering pain-killers, or to carry equipment such as defibrillators (for treating heart attacks).

The third question is the role of the private sector. Here the most interesting example is Denmark, where a private company, Falck, provides two-thirds of the country's fire service, under a law dating from 1926.

The remainder is run by local authorities. “The municipal stations were cosy and old-fashioned, just like here,” observes a British fire insurance expert who visited recently. “The Falck ones were like a modern office—there was no comparison.” This allows a much more effective use of time: Falck firemen not only run the ambulance service, but also the vehicle breakdown service. Their workers are better trained than municipal firemen, and earn more.

In value-for-money terms, Britain's fire service does not perform particularly well by international standards. Countries such as America, Denmark, New Zealand and the Netherlands do better (see chart) in terms of the protection they get for the amount they spend.

Britain's fire service is badly managed (as the fiasco over the current pay negotiations highlights). The incentives are wrong. Fire services are funded according to the number of fires and call-outs. In Denmark, the contract is for a flat fee, which encourages efficiency. In one recently-discovered British scam, off-duty firemen in the West Midlands made hoax calls at the ends of shifts to trigger extra pay for their colleagues. The service is overmanned by around 20%. Some 10,000 of the country's 50,000 full-time firemen may go if a pay deal trades efficiency gains for higher wages.



It now looks likely that the government will beat the firemen over pay. Public support is dropping, as taxpayers slowly realise what a bad bargain they are getting. The hoots from supportive motorists are getting scarcer. At the fire station on London's Albert Embankment, pickets have been reduced to hooting themselves, in the hope of a friendly answering honk.

The firemen will probably end up giving ground on modernisation. They may even have to sacrifice their ridiculously indulgent shift system, whereby they work two days and two nights, then get four days off—thus allowing them to run lucrative sideline businesses—typically plumbing, roofing and driving taxis.

But nobody seems particularly interested in a big shake-up. This is odd. Britain's lifeboats are run by volunteers, which suggests there is public spirit about. Contracting out to the private sector has worked well in areas such as prisons. But, in the current atmosphere, the government would no doubt regard such novel ideas as inflammatory.

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Trade unions

Arthur's sons

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How dangerous is the rise in union militancy?

PA

Gilchrist broods by a striker's brazier

INDUSTRIAL militancy to pursue political ends is not on, says Tony Blair, hinting that striking firefighters may be attacking his government as Arthur Scargill led miners in an assault on Margaret Thatcher's government in 1984. The Fire Brigades Union (FBU) website, which proclaims the “ultimate aim (of) the bringing about of the Socialist system of society”, looks like good evidence for the claim. But theories of tightly-knit conspiracies by a new breed of politically-motivated men taking the helm of Britain's trade unions are wide of the mark. What's going on poses a different sort of danger to the government.

Trade-union leadership has undoubtedly become more left-wing and militant in recent years. The new lefties include the two rail union leaders, Bob Crow (RMT) and Mick Rix (ASLEF), who have both been members of Mr Scargill's Socialist Labour party. Both have had meetings with Andy Gilchrist, the FBU leader, apparently to discuss sympathy action that they might take in support of the firefighters. But despite Mr Crow's enthusiasm, the number of London Underground train drivers refusing to turn up for work on “safety grounds” has been in low single figures.

Beyond this grouping, the left-wing conspiracy theory founders. The three leaders appear to want to have little to do with Mark Serwotka, a Trotskyite and general secretary of the PCS union which mainly represents civil service clerical and administrative grades. Neither, apart from supportive noises, is there much sign of political or other sympathy action from two other leaders generally reckoned to be part of the awkward squad—Billy Hayes, general secretary of the CWU postal workers union, or Dave Prentis, leader of Unison, the local government and health workers' union. Mr Prentis, indeed, may not be quite as left-wing as he is painted; he beat two challengers to the left of him when he was elected in 2001.

What does link these men is that they all stood as non-Blairites. Indeed, being labelled as close to the government is nowadays a sure ticket to losing a trade union election. That is mainly why Sir Ken Jackson was beaten this year by the relatively unknown Derek Simpson for the leadership of Amicus, the engineering and electricians' union. Mr Simpson quite likes to portray himself as a firebrand, ready to tear up many of the no-strike agreements successfully negotiated by Sir Ken during the 1990s in exchange for union recogniton. However, he also claims to be a supporter of the government and is opposed to such iconic leftist action as secondary sympathy strikes.

Nevertheless, Blairism has gone out of fashion with trade unionists because, after the minimum wage, the European Union's “working time directive” and other goodies given to them in Labour's first term, the government has run out of relatively painless concessions to make. Trade union members, particularly those in the public services, are now much more agitated about getting some of Gordon Brown's big spending increases into their pay packets. Thus, says a Labour MP who is a seasoned trade union observer, political action by the unions is directed almost exclusively at government policies which impinge directly on workers' pay and conditions, such as contracting-out of public services to private companies.

The leaders of two of the biggest unions, Bill Morris of the transport workers and John Edmonds of the GMB general workers union, are retiring next year and are likely to be replaced by men who have invested far less in getting a Labour government elected and who are likely to be more distant in their

relationship with it.

The most surprising swipe at the government during the fire strike has come from John Monks, general secretary of the Trades Union Congress. Mr Monks, once seen as the very model of a modern trade unionist, attacked the government's management of the strike and called for unions to support the firefighters. His bitterness—he once said that the government treats unions as if they were an embarrassing relative—is the result of what he sees as neglect. He hoped that Mr Blair would sign up for the kind of “social partnership” between government and the unions that exists in many European countries. Mr Blair was not interested.

If the government is so determined to keep the unions firmly at arms' length, then it is not surprising if a new generation of union leaders feel the same. That should not matter to the government, save for one thing: next year, for the first time in a decade, the unions, under a law introduced by Margaret Thatcher, have to ballot their members on whether to maintain a political fund, most of which has traditionally been used to finance the Labour Party. Unions provide 90% of Labour's cash. It's not likely that many unions will actually disaffiliate, but some will wonder if they can't find better uses for their money than bankrolling a Labour Party that no longer loves or even listens to them.

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New architecture

Je t'aime à la folie

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Fashion is folly, and the folly is in fashion

NO ONE can agree what a folly is exactly, or what it isn't. Through the ages, the British have built follies of whalebone, follies that are lined with shells or shaped like a pineapple, a volcano, an elephant bearing a castle or even carved with pine cones to look as if they were grown from seed. Lady Scott, a true Miss Havisham, built hers to assuage her grief; Sir Hector Munro to celebrate his own courage. The Earl of Aberdeen dedicated his to his brother, killed at Waterloo. “Rather you than me”, ran the inscription.

A decade ago, the old British fondness for putting up odd, cheerful buildings on pretty parts of their estates seemed to have faded, perhaps because the folly was supplanted by the garish charms of installation art. Add to that the complexities of the planning system and the rising cost of construction, and most modern folly patrons have been thinking twice before signing up to the tradition. But that may all be changing, with a rash of new follies springing up across the landscape: in recent years, the Forbidden Corner, a magical reverie topped by a weathervane in the shape of an arm and a leg has been built in Yorkshire, along with Leeds Castle's grotto in Kent and Sir Paul Getty's wood and bark hermitage in Buckinghamshire.

Now two men are vying to make the point that modernist buildings can, if they are well designed, enhance rural landscapes rather than ruin them. Niall Hobhouse, an independent-minded London art dealer, cast off all his Georgian shackles when he commissioned the 79-year-old Peter Smithson (who, with his wife Alison, designed *The Economist* tower in central London) to build him a modern obelisk in the park of his stately home, Hadspen House, where his family has lived for over 200 years.

In summer, the 50-foot-high, three-legged spiral skeleton, of Hadspen oak with a spine of stainless steel, seems literally to be growing out of the ground; in winter it takes on the form and colour of the ancient leafless trees on the ridge above. The shape of the tower differs from every angle, forcing you to walk the whole way around it before it imparts all its secrets.

Henry Keswick, a Hong Kong *taipan*, will be looking to top even Mr Hobhouse's modernist ambitions. The new pavilion that will be unveiled early next year on Mr Keswick's Wiltshire estate has been designed by I.M. Pei, who created the glass pyramid at the Louvre. Mr Pei's first building in Britain may be a folly, but by picking serious architects, both Mr Keswick and Mr Hobhouse have ensured this old tradition has a fine future. It would be folly for others not to follow their example.

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Gated communities

Shut up

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British people like the idea of gated communities. The planners don't.

Get article background

PA

Happily behind bars

CRIME, traffic, noise, graffiti—no wonder that many people in Britain like the idea of living somewhere safe, fenced-off and privately guarded. Sir Denis and Lady Thatcher bought a place in a "gated community" in south London. The former Chilean dictator Augusto Pinochet stayed in one while in Britain in 1999. Some of Britain's top footballers do the same.

No surprises there—the rich and famous have always valued their privacy, and old people their security. But a new survey commissioned by the Royal Institution of Chartered Surveyors (RICS) says that two-thirds of young people would like to live behind such bars. Other strong support comes from poor people (presumably because they tend to be the victims, as well as the perpetrators, of crime).

A fine opportunity for property developers, then? Not yet. Gated communities are rare in Britain. And they will stay that way if the planners have anything to do with it. Both the government and the RICS fear that gated communities will lead to such buzzword social ailments as polarisation and exclusion. The government has just commissioned research on how many gated communities already exist. In London, the mayor wants 30-50% of new houses to be socially mixed—exactly what the gate-lovers are trying to avoid.

Some of America's gated communities have a creepy feel; some have unpleasant policies such as (formally) no children or (informally) no blacks. Yet the desire to be gated is mainly a reaction to the state's inability to make cities liveable. While the government talks about "yob culture" but fails to sort out the criminal justice system, it is quite understandable that people want to buy a solution for themselves.

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Criminal justice

Politicians out

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European law is taking away politicians' powers over judges

THIS week the Law Lords decided that ministers should be stripped of their powers to decide how long murderers should spend in jail. The decision is important not just because more than 200 murderers, a third of whom have served longer than the original court's recommendation, will be able to apply to have their sentences reviewed. It is also another move in the direction set by the European Court of Human Rights of strengthening judges' power at the expense of politicians.

Ever since Parliament abolished the death penalty in 1965, successive home secretaries have defended their right to be the final arbiter of the term murderers must serve before they can apply to the parole board for release. They have always justified this as the democratic price of putting an end to the death penalty.

The cynical use politicians make of this power undermines that argument. Last weekend, David Blunkett, the home secretary, let it be known that four notorious child murderers must serve at least 50 years in jail. This move was leaked to the *News of the World* two days before the Law Lords' ruling.

This week's case was brought by Anthony Andersen, a lifer who had kicked two men to death. Mr Blunkett extended his 15-year tariff to 20 years. The judges decided that this breached the European Convention on Human Rights.

While European law is taking away politicians' power to intervene in individual cases, Mr Blunkett wants to tighten his grip on the sentencing framework. He is promising to introduce legislation to set tough minimum jail terms for the most serious crimes. Ministers are, of course, entitled to decide what sentences should be available to the courts. Yet trying to restrict judges' freedom can make a nonsense of sentencing policy.

The Murder (Abolition of Death Penalty) Act of 1965, for instance, lays down a sentence of mandatory life imprisonment for all murders. Since murder covers everything from mercy killing to the most sadistic killing, it would be manifestly unjust if all murderers got life. They don't. The lord chief justice sets the “tariff” (the real sentence) and most “lifers” serve not much more than 14 years. The main consequence of the mandatory life sentence, then, is to make the law look silly, which is something a home secretary should in general try to avoid.

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Pre-budget report

Mr Brown is too optimistic

Nov 28th 2002
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The deterioration in the public finances is more than cyclical

PRESENTING this year's pre-budget report must have been a painful experience for Gordon Brown. Since 1997, his big budgetary setpieces have generally been occasions when he could announce good news, with revenues rising faster than forecast. Not so this time: the chancellor of the exchequer had bad news to deliver.

Like the chastened finance director of a troubled company, Mr Brown had to own up to a whole series of downgrades. His unrealistic growth forecasts in the April budget were duly brought down to earth. The chancellor now expects the economy to grow by 1.6% this year rather than the 2-2.5% he forecast in April; and by 2.5-3% in 2003 rather than the 3-3.5% he was expecting in the budget.

More galling still, Mr Brown also had to own up to a tide of red ink that has swept his famed surpluses into history. In the budget, he had forecast borrowing of £11 billion in the current financial year ending next March and £13 billion in 2003-04. He is now predicting much higher deficits of £20 billion and £24 billion respectively—bigger revisions than the City had expected him to make.

Unsurprisingly, Mr Brown came armed with excuses to account for all this bad news. Taking his cue from previous chancellors who got it wrong, he blamed the world economic slowdown, the worst he said in three decades. He boasted that the British economy had fared relatively well in the face of this setback to global growth. Furthermore, higher borrowing was no cause for shame when the economy was temporarily weak.

However self-serving, most of these arguments make sense. The real weakness in Mr Brown's position lies further ahead. Although his new forecasts for borrowing are significantly worse over the next couple of years, by 2005-06 they are more or less the same as in the budget. By then, the borrowing will once again be used only to finance investment rather than current spending as well. In short, the chancellor is predicting a cyclical reversal to the public finances rather than a structural shortfall.

This is implausible. The scale of the deterioration in revenues is much bigger than you would expect from a cyclical downturn. The Treasury's new estimates show that much of this has arisen from lower profits in financial companies, which have been hit by the end of the equity bull market. Contrary to Mr Brown's forecast, this shortfall is likely to persist for longer than the next two financial years.

According to John Hawksworth, an economist at PWC, an accountancy firm, the chancellor is also being over-optimistic in his forecast for GDP growth, which is vulnerable to a housing market bust. Danny Gabay, an economist at J.P. Morgan, concurs, saying that the fiscal plans will be “blown out of the water” if the economy turns sour. Mr Hawksworth estimates that there will be a £10 billion hole in the public finances by 2006. No prizes for guessing how the hole will be filled.

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Bank of England

The new king

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A new governor—and longer odds on Britain joining the euro in a hurry

THE biggest surprise in Gordon Brown's pre-budget statement on November 27th was not his fiscal forecasts. Rather it was that he chose this moment to announce the next governor of the Bank of England. Mervyn King, currently deputy governor, will take over from Sir Edward George next July.

Mr King certainly merits the appointment. Since joining the Bank in 1991, he has been the principal architect of the successful inflation-targeting regime introduced ten years ago in the wake of Britain's ignominious exit from the European exchange-rate mechanism. Since 1997, he has been a member of the Monetary Policy Committee, the key interest-rate setting body which Mr Brown established when he made the Bank independent days after Labour took office.

Despite his distinguished career, it had been rumoured that Mr King might lose the race to be governor to Andrew Crockett, who has been running the Bank for International Settlements, the central banks' bank in Switzerland. Mr Crockett was generally seen as the candidate who favoured joining the euro. By contrast, Mr King, who witnessed first hand Britain's humiliation when it was forced out of the ERM in 1992, is regarded as more of a sceptic. In evidence to Parliament in 1999, he speculated that it could take hundreds of years to establish whether Britain was genuinely convergent with the euro-area economy—the key condition for Britain to make a success of joining the euro.

Mr Brown has until June to announce the results of the Treasury's assessment of whether Britain now passes the five economic tests he has set for euro-membership. The government's decision to appoint Mr King sends an early signal that the answer will be no; and that a referendum will be postponed until after the next election, due in 2005 or 2006.

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Public-sector pay

Too high, not enough

Nov 28th 2002
From The Economist print edition

Public-sector pay is set to grow uncomfortably fast

WITH firemen and teachers striking this week for higher pay, the government is in a tizz about the potential economic damage from inflation-busting public-sector wage demands. In his pre-budget statement, Gordon Brown said "we should not put our hard-won stability at risk by yielding to inflationary and unaffordable pay settlements."

How serious is the risk? Earnings grew by over 5% in the public sector in the financial year to March 2002, outstripping private-sector earnings growth for the first time in nine years. Since then settlements have fallen back to a little above 3.5% and are again rising less rapidly than the private sector. But this slowdown looks set to be short-lived. A number of long-term settlements with big groups of workers (see table) is about to push up the public-sector average.

New deals

Selected current long-term settlements in the public sector

Organisation	Start date	No. of years	Total value, %	No. of employees '000
Local government*	April 2002	2	7.8	1,300
Met Office	July 2002	3	17.0	2
Ministry of Defence	August 2002	4	20.0	50
Inland Revenue	August 2002	3	15.1	68
DEFRA	August 2002	4	25.5	11
National Health Service	April 2003	3	12.5	1,200

Sources: Incomes Data Service; Department of Health *England and Wales

The first of these was struck with local council employees in September and will not show up in pay packets until October; as a result, it is not yet included in the national figures for public-sector earnings growth. The agreement, worth 8% over two years, covers 1.3m workers, a quarter of public-sector employees. Another big settlement, reached on November 28th, will cover over a million employees in the National Health Service (NHS). Under the agreement, basic pay will increase by an average of 12.5% over the next three years. Of this, 10% will be normal pay increases and an additional 2.5% will reward more flexible working and ensure that the health service pays equal wages for equal work as the law requires.

The government is also hoping to reach a three-year deal with the 500,000 teachers in England and Wales. "What this means," says Alastair Hatchett of Incomes Data Services (IDS), "is that about two-thirds of public-sector employees should shortly be covered by long-term deals offering pay increases of 4-5% a year." In principle, some of the extra pay will either improve the quality of public services or achieve productivity savings. For example, the hope is that a reduction in teacher workloads should improve the quality of teaching; more flexible working in the NHS should improve productivity. In practice, however, most of the increases will amount to a straightforward rise in pay well above the targeted inflation rate of 2.5% a year.

If regular public-sector pay is set to grow by 4-5% a year, total earnings, which includes all other elements of wages like bonuses and overtime payments, will grow even faster. In 2001-02, for example, public-sector pay settlements ran at under 4% but overall earnings rose by over 5%. This was the result of special payments such as the supposedly performance-related payments of £2,000 to thousands of teachers. Next year, similar boosts to the overall pay deal are likely to occur as a result of the need to

recruit and retain staff in London and the south-east. On November 26th, 1,000 schools in London were closed to pupils as teachers staged a one-day strike to double their London allowances to the £6,000 paid to police officers.

In itself, a rise in public-sector earnings of 5% or so would not be a disaster for the economy next year. From a macroeconomic perspective what matters is total earnings growth. The Bank of England gets twitchy when this exceeds 4.5%, which allows for the inflation target of 2.5% and productivity growth of 2%. But private-sector settlements have been quite low, averaging 3% in the third quarter, according to IDS. With little prospect of a return to the heady days of big bonuses, restrained private-sector earnings growth should offset the rise in the public sector.

The real problem for the government is that pay increases on this scale will gobble up spending intended to improve public services—and still leave recruitment and retention problems in London and the south-east, where a quarter of Britain's population lives. Nursing and teacher vacancy rates are much higher in the capital than elsewhere in the country. The reason is clear: public-sector workers in hotspots get much less extra pay to compensate for higher living costs than do private-sector workers. At present, for example, teachers in inner London get an allowance of just over £3,000 a year. But according to NERA, an economic consultancy, they should get more than £9,000 extra to make them as well off as their counterparts elsewhere.

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Bagehot

There's nothing like an enemy

Nov 28th 2002
From The Economist print edition

Beating the firemen is a necessary but not sufficient answer to union militancy

WHETHER it was, as some headline writers insisted following the prime minister's direct intervention on Monday, Tony Blair's “Maggie moment”, one thing was clear: however many wretched weeks on the picket line it may take its leaders to realise it, the Fire Brigades Union, thanks to its own pig-headed stupidity, is heading inexorably for humiliating defeat.

As the dithering and confusion that characterised the government's handling of the dispute until Monday amply demonstrated, Mr Blair, unlike Mrs Thatcher with the miners, did not pick a fight with the firemen as an act of policy. With the threat of a terrorist outrage hanging over the country and the need to ready troops for possible war with Iraq without the distraction of providing a stand-in fire service, such a policy would have been reckless in the extreme.

But from the moment he (belatedly) understood the nature of the threat to the government's political authority posed by the firemen, Mr Blair knew exactly what he had to do. Labour's 18 years in the political wilderness was ended, in part, by Mr Blair's commitment (and the electorate's inclination to believe him) that no government led by him would preside over the kind of industrial anarchy that destroyed Labour's legitimacy in the 1970s. Even after five years of relative industrial peace and denying the unions so much as a walk-on role in the New Labour “project”, Mr Blair appreciates, thanks to endless focus group polling, that the union bogey could very quickly reappear.

And, once having decided to do it, taking on and hammering the FBU into submission is not actually very difficult for Mr Blair. When he convinces himself that a particular course of action is “the right thing to do”, as he has about Iraq, he is firm of purpose and untroubled by doubt. The firemen's cherished restrictive practices are so egregious, their wage demands so exorbitant and their tactics so blatantly extortionate that they have galvanised Mr Blair with the moral certainty that domestic politics often fails to provide him.

By encouraging his members to believe that striking could deliver them a “no-strings” 40% rise, the FBU's leader, Andy Gilchrist, opened a Pandora's Box that will not now be closed until a much leaner, more flexible and efficient fire service emerges. Despite the mixed messages of recent weeks, on this the government and the vast majority of Labour MPs are united.

However, it does not follow that even the exemplary defeat of the firemen that the leaders of other trade unions now fear will make it any easier for the government to resolve pay issues elsewhere in the public sector. For on one thing at least Mr Gilchrist was right: the firefighters are indeed a special case. The prime minister can take the line he has with the FBU because there are so many people queuing up to be firemen at a time when fewer of them are actually needed (although whether it will be quite such a popular occupation when it becomes a full-time job is another matter). But elsewhere in the public sector it is a very different story.

And then the rest

There are chronic shortages of nurses (only partially bridged through overseas recruitment and expensive agency staff) combined with crippling rates of staff turnover. Unfilled GP vacancies have tripled in the last two years. The army, groaning from over-stretch, cannot recruit the number of troops it needs. And in London, where there was a one-day teachers' strike on Tuesday, 6% of teaching posts are entirely unfilled, while a further 18% are occupied by people without adequate qualifications or by teachers from overseas on short-term contracts.

Although some of the improvements in public services the government has promised will come from new buildings and modern equipment, most of it will depend on retaining good people, persuading them to work more efficiently and recruiting more like them.

The government thinks it has an answer. It boasts that in the last couple of years it has been working hard behind the scenes to impose a more coherent and rigorous approach on the various pay review bodies that cover most of the important public-sector workers. The current trend is for generous-looking three-year settlements that tie some of the money to delivery of the government's “modernisation” agenda (a new refinement is to make the National Audit Office responsible for policing the discretionary elements in some of these deals).

Unfortunately, this does absolutely nothing to address the real problem—nationally negotiated settlements which over-reward in some parts of the country where the cost-of-living is low and the supply of workers plentiful, while failing to address the low disposable income and difficulties of recruiting in London and the South East that are also fuelling public-sector union militancy. The government wants the pay review boards to target specific labour market issues, such as expensive housing, by direct subsidy and special payments (London “weighting”). But it's a clumsy, messy approach.

The solution ought to be clear enough: ideally, pay deals should be negotiated locally and should reflect local market conditions. But as long as central government provides 70% of the money for local government, it is hard, if not impossible, for it to let go. The government also suspects (with reason) that too many local government negotiators, like the feeble characters who thought they had cut a deal with the firemen, would prove to be a soft touch for determined unions. It's a real dilemma and one to which the government has no good answer.

Mr Blair is splendid when he is faced with an enemy to be defeated. He is, however, rather less so when it comes to the patient, long-term strategic thinking on which lasting success is usually founded.

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United Airlines

A special thanksgiving

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As it heads towards bankruptcy, what was once the world's biggest airline faces a struggle to survive

THE first Sunday after Thanksgiving is traditionally the busiest day of the year for airlines in America, as millions head home after spending a holiday with relatives and friends. Traffic this year will be 10-15% below the peak of two years ago, even though fares are on average 18% lower than they were then. Longer check-ins, security hassles, a slump in business travel and fear of flying are still depressing America's carriers. Collectively they will lose around $9 billion this year, slightly more than in 2001.

But this weekend has a special significance for United Airlines, which could wake up with a horrible holiday hangover. United used to be the biggest airline in the world; now it is just the biggest loser. Losses last year were $2.1 billion, a record in an industry where competition for this title is tough. This year United looks like losing even more: around $2.3 billion. Recently the airline has been burning cash at the rate of $7m a day, destroying the healthy pile with which it entered its latest crisis. Unless it gets a bail-out, in the form of a $1.8 billion government loan guarantee, something that looks far less likely after union members rejected pay cuts on November 27th, United could be forced into Chapter 11 bankruptcy by December 2nd, when loans worth $375m fall due.

Contrary to widespread thinking, United's problems were deep-rooted long before September 11th floored American aviation. For years, the airline has been the industry turkey. Rivals groaned at the way it inflated wage costs for all, by doling out huge rises. They ground their teeth as its bungled negotiations led to industrial action in the summer of 2000. Even before September last year, it was heading for a loss of over $1 billion, largely because of its overcapacity and those generous pay rises. It tried to solve its problems by taking over a smaller rival, US Airways, but antitrust authorities blocked it. A venture into business-jet services also proved a dud, when nobody would put up capital for it.

Pay became a serious issue in the summer of 2000, when the employee share-ownership scheme, devised to save the airline in its previous brush with bankruptcy in 1994, came to an end. Pilots and other employees had accepted wage cuts of around 15%, and a six-year pay freeze, in return for shares, which led to the airline being 55%-owned by its staff. This clout in the boardroom meant that United often appeared to be run for the benefit of its employees rather than ordinary shareholders, with higher operating costs than rivals such as American Airlines or Continental.

In the event, weak labour management and bloated costs meant the shares sank, so the workers became keener to grab big pay increases to compensate for their period of austerity. Pilots won phased increases of up to 45%; other workers such as mechanics threatened to strike unless their pay was similarly boosted. United mechanics became the highest paid in the business, after they flexed their muscles.

Now the wheel of United's fortunes has turned again, and it is time for more employee sacrifices. Last summer the airline sounded out the government's Air Transportation Stabilisation Board (ATSB, formed to funnel aid to America's airlines after September 11th). But its pile of cash and the unconvincing nature of its recovery plan meant it got nothing.

Talking turkey

Now, United is on to its third chief executive in 12 months. Jim Goodwin upset the unions last autumn, talking of austerity, and had to go. His replacement, John Creighton, a 69-year-old, left after some months. Today's boss, Glenn Tilton, a veteran oilman who used to run ChevronTexaco, has worked hard since he was appointed in September to devise a recovery plan robust enough to convince the government that it is worth underwriting further loans. (United, like other American carriers, has already had a $1.2 billion hand-out to compensate for the effects of the terrorist attacks).

Mr Tilton's plan, which the ATSB has been studying in recent weeks, is certainly ambitious. He claims it will convert United losses into operating profits in 2004, enabling any guaranteed loans to be paid off in 2005-2007. The guts of the plan are labour-cost savings, which the company reckons will produce $5.2 billion over the next five-and-a-half years. On November 18th pilots ratified an agreement their leaders had drawn up with Mr Tilton. This would introduce an 18% pay cut and cancellation of other rises due in the coming years. But the pilots have secured the right to have their pay restored to today's levels by May 2008. Such “snap-back” clauses were just what undermined 1994's wage cuts, when pay was restored in 2000.

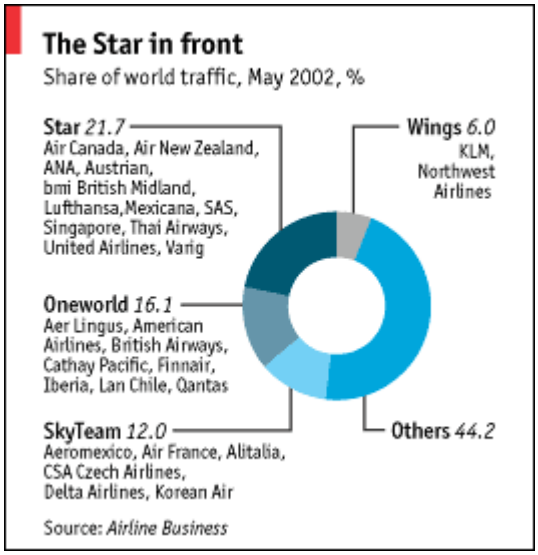
Another part of the pilots' deal is that they will allow management to use more small, regional jets flown by pilots who earn less than those who fly large aircraft. Such restrictions, which affect all big American airlines, reflect the disproportionate power that unions enjoy in the airline industry. They are also a big cause of inefficiency, because airlines are forced to fly large planes half-empty on many routes feeding into hubs, when the sensible thing would be to fly with smaller aircraft, which could undertake more trips if demand suddenly increased.

Flight attendants have also agreed to a pay cut of 4% and forsworn future rises due under their “snap-back” scheme. They too have been promised some jam tomorrow, with wages restored in 2008.

But both these deals are now jeopardised by the rejection, by the mechanics and ground staff represented by the International Association of Machinists, of a tentative deal, involving a 7% cut, that had been agreed with management on November 25th. The rejection of this deal by union members on November 27th puts at risk any chance of an ATSB loan guarantee.

The two other elements of the Tilton plan were more promising: cut-backs in the company's fleet and in its network. Employee numbers have already come down from 100,000 in September 2001 to 80,000 now; another 6,000 reduction will come over the next couple of years. Capacity has already been cut by 17%, with a further 6% reduction over the next 12 months. As more small aircraft join the fleet, United is getting rid of 139 large, older jets to make itself nimbler and to align its capacity with today's lower demand. Capital spending is being cut by $2 billion a year; and deliveries of aircraft on order (all but one from Airbus) have been postponed until 2006.

It is not just employees, Uncle Sam and suppliers who might help United. Its airline alliance partners will play a part. United is a founder and core member of Star, the largest airline-alliance group (see chart). Two partners, Lufthansa and Air Canada, have indicated that they would be prepared to put some money into United to help it recover. Mr Tilton is also counting on them to boost revenues.



Even if these allies rally round, United is unlikely to stave off Chapter 11. Unless it gets an extension on the loan due on Monday, it will have to seek court protection from creditors. The danger for other airlines is that a bankrupt United, with no interest bills to pay, lowers fares to chase market share. Yet the procedure has worked before. Continental Airlines went through it twice, in different guises, to emerge as one of the best-run carriers. Employee-shareholders will, however, get a double dose of pain as a harsher restructuring takes place. This week's vote by mechanics, albeit on the eve of Thanksgiving, really was turkeys voting for Christmas.

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Iberia

Viva España

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Why Iberia is flying high

WHILE America's airlines are still bleeding, European carriers are recovering rather well. Even Spain's Iberia, one of the weakest, is now surprisingly rampant. Seven years ago, it was an inefficient, loss-making state-owned airline. But by April 2001, Iberia had been largely privatised. The markets now think it is worth almost as much as American Airlines, Continental and United combined (though that is not saying much these days). Along with Air France, it was Europe's only profitable large carrier last year, before recovery arrived at British Airways and Lufthansa.

Iberia was already cutting costs and increasing flexibility before September 11th. Xabier de Irala, the company's president since 1996, agreed to take the job on condition that the Spanish government, which maintains a golden share in Iberia, kept its nose out. So far, it has done so. His background was 25 years at General Electric and ABB, far removed from the airline industry. But he quickly shed unprofitable, mostly domestic routes, increased service on profitable ones and cut the labour force.

He also started to use wet leasing (the industry's equivalent of hiring temporary workers and aircraft along with them). Banned in the United States and used sparingly by large European carriers, wet leasing accounts for about 10% of Iberia's capacity today. After September 11th, wet leasing allowed Iberia to cut capacity quickly. That, together with a rapid renegotiation of delivery and payment on the 18 new aircraft it had on order from Airbus, kept its capacity tight.

It also helps that hard-hit north Atlantic traffic accounts for only 4% of Iberia's total. Surprisingly, the crisis in Argentina has not cut traffic to and from that country; indeed, it increased by almost 7% last year. Iberia's share of the Latin American market is actually growing by over 9% a year.

One day, Iberia and British Airways, which owns 9% of Iberia's shares, would like to merge. But European antitrust regulators would force any merged airline to give up too many profitable European routes. So Iberia's membership of the oneworld alliance is a temporary solution. Meeting in Madrid last week, oneworld's members decided to co-operate on maintenance and engineering to cut costs. That may help Spain's transformed airline to fly even higher.

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AOL Time Warner

You've got trouble

Nov 28th 2002
From The Economist print edition

Arranging a future

Reuters

Potter has a vision

Get article background

IT HAS been a cracking autumn for AOL Time Warner's content makers. The second “Harry Potter” film has stormed the box office; in December, the “Lord of the Rings” sequel is set to do the same. Two of its television series, “Friends” and “The West Wing”, scooped the top two Emmy awards. The new series of “The Sopranos”, on the company's HBO cable channel, opened with higher ratings than any broadcast network that night. Which makes it all the more galling to Time Warner's people that the group is being dragged down by troubles at AOL, the Internet arm that was originally supposed to reinvigorate Time Warner.

On December 3rd, AOL promises to put them out of their misery. At an “AOL Day”, it will unveil plans to turn around the troubled division, which is beset by dwindling subscriber growth, shrinking advertising revenues and investigations into its past accounting practices. Nothing has been announced. But insiders suggest that there will be three main elements to the plan.

The first will be an overhaul of advertising strategy. Under its new head, Jonathan Miller, AOL has purged the ad team that led the reckless sales deals of the past, some of which are now under official investigation. Irritating “pop-up” ads are out. AOL will now concentrate on new forms of “relationship advertising”, such as sponsorship, which exploit, for instance, the video content made possible by a high-speed Internet service.

Although nobody (people at AOL included) remotely expects this to restore the inflated advertising growth of the past, it points to the second feature of the rescue plan: a firm push into broadband. In the past, this idea has been fiercely resisted in some quarters. AOL flourished on the back of its simple-to-use, and lucrative, dial-up service. In theory, if people will pay for it, broadband offers the chance of extracting more revenue by charging for some of the faster and better-quality content that it delivers. In practice, though, the transition is costly. Margins on AOL's dial-up customers are 55%, according to Merrill Lynch; on broadband customers, they are just 18%. This is chiefly due to the steep fees that AOL pays cable operators. Access to its cable system was an important reason for AOL's bid for Time Warner, but the link has bedevilled AOL's negotiations with rival cable carriers.

Yet, as Mr Miller has realised, AOL cannot afford to be left behind, not least because its rivals, including the cable companies themselves, are pushing their broadband services aggressively. Microsoft's MSN has been particularly vigorous. As John Frelinghuysen at Booz Allen, a consultancy, puts it: “AOL either trades up customers, or it loses them.”AOL will now push both its own all-in-one broadband package and a separate “top-up” to a standard broadband connection.

All the same, the immediate impact on profitability could be dramatic. Merrill Lynch predicts that AOL's earnings before interest, tax, depreciation and amortisation could shrink from $1.7 billion in 2002 to $830m by 2005—unless, that is, the company can extract more revenue from subscribers with “HBO-style” premium content. Which leads to the third part of the rescue plan: the use of exclusive in-house content for premium broadband services. This implies a complete U-turn in the relationship between AOL and its sister content divisions.

In the early days of the merger, when Bob Pittman was trying to bash division heads together to extract synergies, the company stressed—with a nod to the regulators—that it would not keep its own content to itself. Today, nobody is fretting about AOL Time Warner's dominance. It is both more publicly acceptable and commercially essential for the group to milk what it has. Since broadband enables more stuff to be shoved down the pipes on to the screen, there is a competitive advantage in having good stuff to shove.

Unlike Microsoft, AOL Time Warner has a rich collection of films, TV programmes, magazines and music to raid to offer sneak previews, clips and music tracks to AOL subscribers—at a price. “AOL will have to have programming that people will pay for,” said Richard Parsons, AOL Time Warner's head, in London in September. “Where better to turn for that than the rest of AOL Time Warner?”

At its least controversial, this implies supplying content to AOL to help with mutually beneficial promotion. What is under consideration, however, may go much further. One idea is to hand over entire chunks of web editorial content from some of Time Inc's magazines, for the exclusive use of AOL subscribers. That such a notion is even on the table speaks volumes for today's smoother relations between the once-arrogant AOL and the resentful content businesses, thanks to the efforts of the low-key Mr Miller and Don Logan, head of one of the two over-arching groups of divisions created by Mr Parsons. Such a radical about-turn in the use of in-house content may not be enough to salvage AOL, even if it happens—but it is about the best chance the company has.

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Fantasy games

Role-playing

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A merger will not take Japan's video-game developers to the next level

ONE is called Square; the other Enix. They are not film characters, rock groups, or a cute new pair of Japanese robots, but companies. And they each have one basic product, which they have been updating and repackaging for their loyal followers since the mid-1980s. So when the two video-game developers announced on November 26th that they would be merging next April, the fame of their role-playing games made it easier than usual to be swept away by the news of a deal. What, after all, is an investor to do when “Final Fantasy” joins forces with “Dragon Quest”?

The answer is to ignore the “Dragon” and “Final” bits, and ask just how many other quests and fantasies have ever led to successful mergers. At best, a combined Square Enix will face the same problems that plagued the one-hit wonders when they were separate. Neither firm, for example, owns a distribution channel. Ben Wedmore, an analyst at HSBC in Tokyo, argues that this gap is crucial, since updated versions of video-games grow stale more quickly than, say, business software: “if people are still interested after nine months, you've got something special.”

That leaves developers desperate to get new games out quickly, giving them little leverage over distributors. Three of Japan's other big developers—Capcom, Namco and Sega—own video-arcade networks. Another, Nintendo, has its GameCube machines and smaller, portable GameBoys. Like many other developers, Square and Enix hope that mobile telephones and other handheld devices will increasingly be used to play games. But why, asks Mr Wedmore, might gamers pay $500 for a telephone that plays video-games, when they can buy a GameBoy for $50?

The firms have chosen different ways to deal with their past success, and that will also make the merger awkward. Square, which makes “Final Fantasy”, has fittingly tried to escape reality, pouring much cash into the search for a new game idea and trying to turn its existing blockbuster into a movie (it flopped). Enix's smaller research team has settled for releasing newer versions of its popular game—trying to make its luck last as long as possible. The “Final Quest”—or perhaps the “Dragon Fantasy”—will be the task of uniting these approaches in a single successful business.

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Energy in Europe

Electric shock

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At last, a single market. Maybe

THE single European market was introduced to great fanfare in 1992. In reality, though, creating a single market for goods and services within the European Union is a process, not an event—and a very slow-moving process it can be. In recent years, the single biggest goal of the liberalisers has been to force a faster opening of the European markets for electricity and gas. Together, these account for over *euro*250 billion worth ($250 billion) of sales every year in the EU. Yet market-opening has been lopsided. The British and Finnish markets are fully open, for example, but all French domestic users still have to buy electricity from their state monopoly, Electricité de France (EDF).

On November 25th European ministers finally agreed a date for complete liberalisation across the EU. All business users will be free to choose energy suppliers by July 2004, and this right will be extended to all domestic users in 2007. The French, who had blocked any such agreement at recent European summits, have changed their position. France had found itself increasingly isolated in its efforts to slow liberalisation. And the interests of EDF, a state-owned giant that is Europe's biggest electricity supplier, now point in the direction of market-opening.

That is because EDF has ambitious goals for international expansion. It had run into a political backlash after recent takeover bids in Italy and Spain. Politicians there had complained that it was unfair to let EDF expand into other European markets, so long as the French market remained closed. That objection will now lose some of its force.

The German energy market may also change as a result of the new EU decision. In theory, the German market is already 100% liberalised. But new entrants have complained that they have been held back by regulatory obstacles. These too will be tackled, at least in theory (though in both France and Germany, it remains to be seen just what happens in practice).

The two biggest consequences of energy liberalisation are likely to be cheaper prices and a wave of corporate mergers, maybe even across European borders. Both effects have already been felt in Britain, since competition was introduced to the energy business. Electricity prices for big consumers have fallen by around 40% in Britain since 1998; 34% of Britons have changed providers; and 55% of British households now get electricity from a foreign-owned company. Companies from other European countries have expanded rapidly in Britain. EDF bought London Electricity in 1998 and Seeboard in 2002, and is now the fourth-biggest electricity supplier in Britain.

This week ENI, an Italian energy company, announced a *euro*2.5 billion bid to take complete control of Italgas (it currently owns 44% of the company). ENI's management cited a desire to take advantage of the renewed impetus for energy liberalisation across Europe as a key motive for the bid. Other energy companies are thinking of making similar moves. Gaz de France has announced ambitious plans to expand internationally and EDF will continue its expansion drive. Observers of the European energy market believe, gloomily, that it may ultimately come to be dominated by three large, well-entrenched national champions: EDF, and the two German companies, RWE and E.ON.

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GlaxoSmithKline

Pay and display

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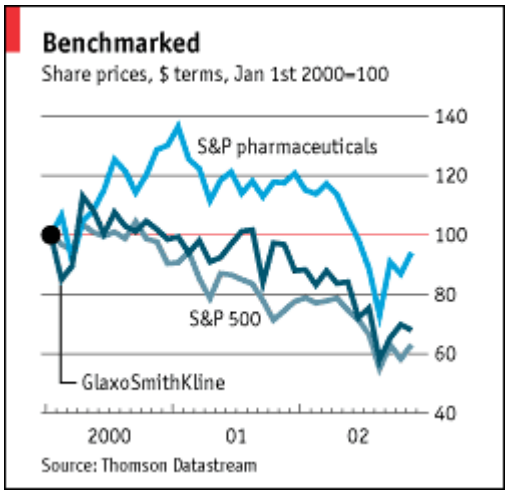
Too fast, Mr Garnier

THE world's second-biggest drug firm, GlaxoSmithKline (GSK), does a thriving trade in medicines for anxiety and depression. Just as well, given the growing unhappiness among British shareholders about the firm's performance.

This week GSK withdrew a plan to reward Jean-Pierre Garnier, its chief executive, with an outlandish pay package worth at least £11m ($18m), after a long and noisy row over it with institutional investors. Only £935,000 would have come as basic salary. The rest would have been a complex mix of share options, free shares and other bonuses.



GSK had argued that this huge package was needed to keep Mr Garnier's incentives in line with those of leading American drug firms. But many British institutional investors, who hold roughly 70% of GSK's shares, balked at the sheer size of the package. Last year, Mr Garnier's pay deal already made him one of Britain's best-paid bosses.

Shareholders also complained that Mr Garnier's performance targets would have been too lenient. Roughly half the shares assigned to Mr Garnier in the proposed deal were to depend on the firm's total shareholder return outperforming the FTSE 100 index over the next three years; the rest on the company achieving earnings growth of at least 9% above inflation over the same period.

Most American drug firms link their chief executive's pay to share-price movements, which British investors consider a poor reflection of management quality. A few, such as Merck, use more complex measures, such as sales growth compared with rival companies. GSK's shareholders wanted to know why most of Mr Garnier's financial incentives were not explicitly linked to GSK's performance compared with that of other drug makers, rather than to the economy as a whole.

Timing was also a problem. Like most pharmaceutical companies, GSK is going through a rough patch. It has recently lost the patent on one of its best-selling drugs, an antibiotic called Augmentin, and could well forfeit its monopoly on two other blockbusters, Wellbutrin and Paxil, should generic challengers succeed in court. It faces lean years ahead, with scarcely any new drugs to launch until 2005. A few key executives have left, and there are many claims that the company needs another merger or acquisition to boost its earnings and shore up its falling share price.

In addition, growing public frustration at the cost of drugs, in America and in the developing world, leaves companies open to accusations of profiteering. Some companies have been more sensitive to the times: Sidney Taurel, head of Eli Lilly, reduced his own base salary to $1 this year.

Mr Garnier has now been forced to accept last year's package. Had he been more patient, he might have avoided the whole embarrassing saga. GSK is looking for ways to compensate for its expiring patents, and it has a strong salesforce. It also has 123 drugs in clinical development. Of course, some of these will fail in further tests, but it would take only a few multi-billion dollar success stories for the company to vindicate its new “experimental” R&D organisation, introduced after the merger of GlaxoWellcome with SmithKline Beecham in 2000. Shareholders may not be willing to wait two or three more years for the fruits of GSK's labours. But if they do, Mr Garnier might then be able to ask for payment on delivery.

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Italy's cultural patrimony

The Colosseum is not (yet) for sale

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From The Economist print edition

Could the private sector do a better job of running Italy's cultural heritage?

THE lights almost went out for Botticelli's “Birth of Venus” and Leonardo da Vinci's “Annunciation”. Last week the Uffizi Gallery in Florence received a final notice from Enel, Italy's electricity company, for non-payment of its bill of *euro*250,000 ($248,250). One of the world's oldest and most famous museums no longer had the cash even for paper towels in the toilets. The explanation, says the culture ministry in Rome, was a communication problem, caused by a reorganisation of accounting arrangements at Italy's museums. But the Uffizi's cashflow crisis is symptomatic of a general problem.

Italy's cultural heritage is its biggest asset. No other country has so much first-class art, so many ancient remains and such a quantity of beautiful piazzas, palaces and parks. According to one UNESCO estimate, Italy is the cultural repository of more than two-thirds of western civilisation. But the state spends little on culture—just 0.18% of GDP—and an absence of tax breaks for donations gives the private sector little incentive to help.

To make matters worse, a bloated state bureaucracy runs Italy's cultural patrimony. Entrance fees are often low, shops unappealing and opening hours short. A tour of the museum of Palazzo Venezia in Rome, in the brief window of opportunity between siesta and cocktail hour, reveals an art display that is inexpertly lit and explained with tiny, typewritten notes in Italian. And the most attractive bits of museums, castles or archaeological sites are often *in restauro*, a near-endless undertaking as funds often tend to dry up mid-way through.

Silvio Berlusconi, Italy's prime minister, is now conducting an experiment. Under the stewardship of Giulio Tremonti, the economics minister, some of Italy's treasure trove will be privatised. Parliament passed the proposal in June, despite howls of protest from the opposition. A new state agency, Patrimonio dello Stato, was set up to value Italy's cultural patrimony and to decide what could be sold, leased or even securitised.

To calm his critics, Mr Berlusconi has promised not to touch treasures that are part of Italy's national identity, such as the Colosseum, the leaning tower of Pisa or indeed the Uffizi. Future owners of shares in Italian cultural treasures will not be able to buy a majority stake. Leases will be limited to five years. Yet the new law is vaguely worded: it does not explicitly exclude a transfer to the private sector of Italy's best-known treasures.

Giovanna Melandri, a former culture minister, is a fierce critic of these proposals. She says that the private sector should be allowed to buy stakes in Italy's cultural heritage only if private owners are obliged to maintain and restore sites and to make them accessible to the public; and provided that the state can take back the site should the new owners not fulfil these obligations. Mr Berlusconi's law comes with no such strings.

In August, Patrimonio published a first list of the value of items that might be sold, securitised or leased. The 800-page document lists cultural treasures, beaches and even prisons. The remains of the Villa Jovis, where Emperor Tiberius stayed on Capri, are valued at just *euro*90,000. The island of Pinosa, off the coast of Tuscany, is listed at *euro*8m. And those tempted to buy San Vittore, a prison in Milan, will have to pay at least *euro*20m.

By the end of the year Patrimonio plans to publish a more specific list of items. The agency will probably need another year really to start privatising Italy's culture. The government hopes that Patrimonio will yield millions, if not billions of euros. It hopes that some of these funds can be used for Mr Berlusconi's pet project, a giant bridge between the mainland and Sicily. But for the millions of tourists who flock to

Italy each year, the big question will be whether the lights stay on in the Uffizi.

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Reebok

Ethically unemployed

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Corporate social irresponsibility

HOW little the dangerous fashion for corporate social responsibility has to do with a truly responsible attitude by businesses is aptly shown by Reebok International. This American sports-goods supplier claims to have pioneered good corporate practice.

Doug Cahn, the company's head of human rights, talks about values, fairness and principles, with all the zeal of an anti-corporate lobbyist. He presents the news that Reebok has just decided to withdraw business from a subcontracted factory in Thailand as a proof of corporate caring. The reason: the 400 or so workers employed there to make shorts and shirts were working for more than 72 hours a week.

It is responsible to press for better standards, but the supply of good jobs matters too. Workers at this Bangkok factory were paid above the minimum wage, with health-and-safety rights that few local manufacturers would offer. Many factory employees in developing countries want to work more hours rather than fewer.

Although Mr Cahn denies it, the company seems to have pulled out to avoid allegations that it was doing business with what critics call a sweatshop. “There are always people outside who want to talk with our factory workers to check our standards,” he says. Reebok has been stung before. One troublesome former factory worker in Hong Kong, Han Dong-fang, hosts a radio show calling for workers to telephone with their complaints. “He is a lightning rod for criticism,” says Mr Cahn, before adding quickly that “criticism is one of Reebok's most valuable resources.”

Reebok may not have done its shareholders a favour either. If a clean corporate image boosted sales in the developed markets, it might be worth paying the price of finding a new factory. Yet astonishingly, given Reebok's long involvement in ethical trading, it does no research to correlate social responsibility with sales or shareholder value, says Mr Cahn. Nor does he know what his division costs the company. Since the most ethical way to do business is to attract investment and offer more people a way out of peasant labour, perhaps this practice should be relabelled corporate social irresponsibility.

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Face value

Whither Singapore Inc?

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Singapore's unique brand of capitalism needs an overhaul. Will Ho Ching do the right thing?

EPA

UNDER Ho Ching's father-in-law, Lee Kuan Yew, Singapore rose, to use his own phrase, “from third world to first”. How did Mr Lee achieve this? He would say it was by consistently ignoring intellectual fads. One such, in the 1970s, held that multinational companies exploited poor countries; Mr Lee busily courted multinationals. Another (to which this newspaper subscribes) suggests that the private sector is usually better than the public sector at running businesses. Mr Lee made sure that the government owned Singapore's biggest companies. In this respect, Singapore was different from Asia's other “tigers”. Hong Kong grew rich as a bastion of *laisser faire*; in Taiwan and South Korea, government may have guided, but rarely owned.

Leaving aside one or two small hiccups, Singapore did well with its brand of “state capitalism”, at least until the Asian crisis of 1997. Then came a short-lived recovery and another recession. Last year, Singapore's economy shrank by 2%; last week the government lowered its estimate for growth this year to only 2%. Lee Hsien Loong, who is Singapore's deputy prime minister and finance minister as well as being Lee Kuan Yew's elder son and Ho Ching's husband, has repeatedly lamented Singapore's lack of entrepreneurialism. An awareness is sinking in among the island's ruling elite that a model that turned a swamp into a metropolis may not work as well when it comes to turning the metropolis into a citadel of the “knowledge economy”. An unprecedented gloom has descended on Singapore Inc.

Ho Ching is the woman chosen to clear the gloom. In May, she was appointed to the helm of Temasek, a government holding company that is the most concrete expression of Singapore Inc. Temasek owns (in effect) controlling stakes in 20 of Singapore's biggest companies and many smaller ones.

Ms Ho is spectacularly well connected. Quite apart from her powerful father-in-law and husband, her brother-in-law, Lee Hsien Yang, also happens to run Singapore Telecommunications (SingTel), Temasek's and Singapore's largest company. In August, Bloomberg, a news agency, ran an article ascribing her prominence to nepotism. The Lees' lawyers rang, and Bloomberg retracted the offending article and paid hefty damages.

Her qualifications are certainly not to be sneezed at. A Stanford-educated engineer, she ably ran Temasek's defence conglomerate for a decade. But the strongest argument for putting someone like Ms Ho in charge of reforming Singapore Inc is precisely those family connections. A trusted insider is more likely to break down the barriers to change in this small country than an outsider would be. That does not, of course, guarantee that she will do this. Asking Ms Ho her plans is not an option, since she declines to grant interviews to foreign newspapers. Temasek's new charter, published in July, is not helpful either. Using ambiguous jargon (“rationalise”, “consolidate”, “strategic development”), it says that the government will keep some companies, allow others to find foreign partners, perhaps divest a few, start a few others, and so on. All possibilities are covered.

Looking at what Temasek's companies have actually been doing is more confusing still. This month, for instance, battle raged over one listed Temasek-controlled company: NatSteel, a steel maker. It appeared to be settled only after another Temasek company—DBS, a bank—agreed to sell its stake in NatSteel to a tycoon backed by the government. Other Temasek companies have botched share offerings, made staff changes, and so on. But as to overall direction, nobody is any the wiser.

Assuming that she plans to do something eventually, is Ms Ho still getting ready for action? Or has she yet to decide what to do? In broad terms, she has only two options, beyond inaction. She can try to become a sort of Singaporean Jack Welch—an analogy actually used in the local press—and run the Temasek stable rather as legend says he ran GE, boosting profits and creating winners. Or she might become a Singaporean Margaret Thatcher, breaking up Temasek and liberating the corporate sector from its government shackles.

The Welch approach would require management genius. Many of Singapore's companies certainly could use a bit of that. Stern Stewart, a consultancy, recently calculated a “wealth added index” for Singapore's companies. This compares returns generated with those said to be expected by the market. The index found that a few Temasek companies, notably Singapore Airlines, have rewarded their shareholders well. Others, such as the oil company, land developer, telecoms operator, shipping line, semiconductor maker and hotel firm, have disappointed. A brilliant manager, with a more aggressive, hands-on approach than has been used of late, could turn them all around.

A time for boldness

One advantage of the Thatcherite approach, which requires less management genius, is that it is so much simpler. It would also be much bolder, breaking with Singapore's tradition. Ms Ho and her family know of the criticism that the present structure stifles entrepreneurship. A common joke in Singapore is that working for Temasek companies is like doing national service.

They must also have become aware of the pariah factor that comes with government ownership. The only way for Singapore's top firms to prosper is to expand beyond their tiny home market, regionally or even globally. But government ownership deters many potential foreign partners. Lee Hsien Yang's SingTel is a prime example. It was defeated in takeover attempts in Hong Kong and Malaysia, in large part for this reason.

Only a fool underestimates this family. Mr Lee senior was bold in his time. The second generation (not least Ms Ho) might yet be as courageous. But the true test will be whether it realises that the most productive thing that it can do is to break up the Singapore Inc that it has inherited.

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Enron: one year on

Corporate America's woes, continued

Nov 28th 2002
From The Economist print edition

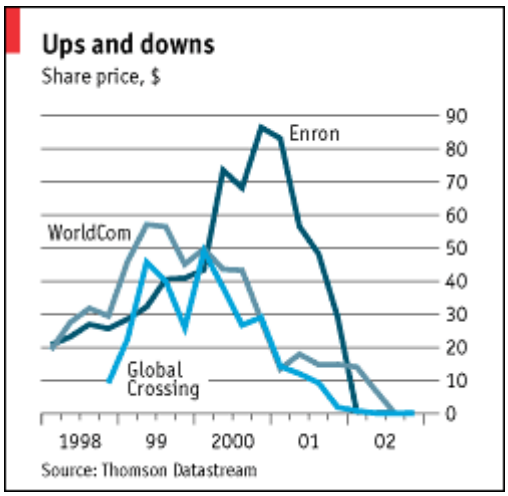
The aftershocks from Enron's downfall a year ago still reverberate

Get article background

DECEMBER 2nd sees the first anniversary of the bankruptcy of Enron, once the seventh-biggest company in America. The downfall of the Texas energy-trading giant dealt a blow to corporate America from which it has still to recover. After a decade of uncontested dominance, the superiority of American-style capitalism was suddenly in doubt. New laws were passed this summer, but there remain plenty of questions about the future shape and appropriate regulation of corporate America.

Enron's original sin was to remove big liabilities from its balance sheet and put them into “special-purpose entities”, financial structures whose special purpose seemed to be to remove unpleasantness from the sight of investors. When this veil could be held up no longer, the company had to restate its profits for the years from 1997 to 2000, knocking more than $1.2 billion off its book value. The change was more than the company could bear: after a half-hearted effort at a merger with a rival firm, Dynegy, it filed for bankruptcy.

Enron's dodgy accounting was not an isolated case. Other companies, it transpired, had also been concealing their true financial position from the outside world. In June, WorldCom, an acquisitive telecoms company, revealed that it had fiddled its accounts to the tune of $3.8 billion in the 15 months to the end of March. Another telecoms company, Global Crossing, went bust after boosting revenues by “capacity swaps” with other telecoms firms—a practice that proved to have been common in both telecoms and energy.



For a while, all this might have seemed just the overdue come-uppance for a bunch of new-economy parvenus. Enron and WorldCom had set out to revolutionise their industries on the back of deregulation (which let them into new markets) and the Internet (which changed the economics of entry). Neither had a seat at the table of America's corporate elite. They were pushy and they were hasty; was it surprising that they stumbled?

Yet it now emerges that some 250 American public companies will have to restate their accounts this

year, compared with only 92 in 1997 and three in 1981. On this year's list are such luminaries as Xerox, which in April paid a $10m fine to settle a case brought against it by the Securities and Exchange Commission (SEC). Xerox admitted that it had overstated its profits by $1.4 billion between 1997 and 2001. The fine was the largest ever paid by a public company for financial fraud.

Not surprisingly, investors have lost trust in the measures of corporate performance that they are given, as well as in the people who give them. Chief executives and accountants have become a despised breed, less trusted even than politicians and journalists. After the excitement of the bubble years, more than half of all households in America own shares. Many have 401(k) pension plans that are heavily invested in the shares of the company they work for—as Enron employees had cause to regret. The spread of equity ownership put the issues raised by Enron and its fellow sinners higher up the political agenda.

Allocating blame

All these issues are encapsulated in the phrase “corporate governance”, a phrase scarcely heard ten years ago. The word “governance” comes from the Greek for “steering”. For a boat to be steered safely it needs a good captain and crew, plus reliable measures and instruments to gauge its progress. But much of corporate America seems, with the benefit of hindsight, to have had neither a good captain nor a reliable way of gauging where it was going.

Blame for the disasters was directed first of all at auditors, shareholders' appointed guardians of managers' accounting probity. One name soon came to the fore. Arthur Andersen turned out to have been auditor of some of the worst deceivers: among them Enron, WorldCom and Global Crossing, the three largest bankruptcies in recent corporate history.

One of Andersen's faults was the unresolved conflict of interest between its auditing and its (faster-growing, higher-margin) consulting business. In 2000, for example, it earned $25m from auditing Enron's books and another $27m from providing various consulting services to the company. Its so-called “aggressive” accounting policies had, in effect, been aggressive cross-selling of its other services.

One of the accounting firms' arguments in favour of doing auditing and consulting under the same roof was that only by offering the promise of glamorous and highly-paid consulting work could they recruit bright, creative young people into their profession. It now seems that some of their recruits were too bright and creative. Auditing is rather like police work; it needs thorough and suspicious minds, rather than creative geniuses.

Andersen was by no means the only big five firm to fall from grace. Xerox's auditor was KPMG. Ernst & Young is being sued (for auditing improprieties) by two federal regulators, the SEC (over PeopleSoft) and the FDIC (over Superior Bank). But Andersen was the only one actually to go out of business. When it was revealed to have shredded documents about Enron, and the Department of Justice decided to bring a criminal indictment against it, Andersen was doomed. From August 31st this year, it ceased to operate. The big five accounting firms became the big four, further shrinking an already concentrated industry.

The second target of investors' wrath was top corporate executives, and the boards that appointed them and condoned their extravagant rewards. Global Crossing's Gary Winnick made over $500m from sales of his company's shares in the two years before it went bankrupt. Kenneth Lay, the boss of Enron, made around $220m. WorldCom's chief financial officer, Scott Sullivan, took some $35m; Kenny Harrison, a mere non-executive director of Enron, $75m.

High rewards were being enjoyed by more than just pushy parvenus linked to dud companies. Investors were shocked to find, from affidavits filed in his dispute with his estranged wife, that Jack Welch had gathered assets of some $500m from his 20-year stint at the helm of General Electric, and that he was being paid a pension of $7.5m a year plus free access to a corporate jet and a Manhattan apartment. This was the first that investors had heard of Mr Welch's pension arrangements, which were not disclosed in GE's accounts.

That such rewards were possible was largely due to share options. Given generously in the 1990s in the hope that they would align managers' interests with those of shareholders, these in effect motivated the unscrupulous to massage their company's figures and persuade their

auditors to go along with them. (In the case of Enron, Andersen did not take much persuading. Partners who objected were moved to other clients.) Insiders exercised their options before accounting deceits were revealed and share prices collapsed.

So far it has proved hard to find anything illegal in much of this. Many accounting dodges that companies exploited were consistent with the letter, if not the spirit, of America's generally accepted accounting principles (GAAP). Share options may (controversially) not have been “expensed”—ie, treated as a cost for the purposes of companies' profit and loss account—but they were listed in footnotes, available for any half-numerate analyst to make the calculation for himself.

The remedy

The Sarbanes-Oxley act became law in July. Drummed up in haste to placate the cries of share-owning America for retribution, the legislation had one main aim: to clean up the auditing process. Among other things, it sets up a Public Company Accounting Oversight Board to oversee auditors; it makes it “unlawful” for accounting firms to offer a number of other kinds of services to companies whose accounts they audit; and it demands that directors sitting on companies' audit committees (who are responsible for choosing the firm's auditors) be “independent”.

The accountants showed they had not lost all their political clout by persuading legislators to dilute a clause in the original bill that would have forced companies to rotate their auditors every five years (on the grounds that objectivity fades with time and familiarity). Instead, the act merely insists that the “lead audit partner” be rotated every five years. “A ludicrous proposal,” says Max Bazerman, a professor at the Harvard Business School.

The act was followed in August by the New York Stock Exchange's proposals for improving corporate governance at NYSE-listed companies. These too put great faith in the idea of director “independence”, proposing that within two years a majority of any listed company's directors be independent of the company—ie, have no material relationship with it.

Some companies plan to go further. Jeffrey Immelt, Jack Welch's successor as boss of GE, has said that he wants a board with two-thirds of its members independent—on the NYSE's definition. Paolo Fresco, the chairman of Fiat and before that a senior manager at GE, and Scott McNealy, chairman and chief executive of Sun Microsystems, are stepping down from GE's board. Both men's companies do business with GE, which means they are not independent. How easy will it be for GE to find directors who are?

The Sarbanes-Oxley act has not got off to a good start. Opposition to it was fierce and it was almost strangled at birth. Only when WorldCom's accounting fraud was unveiled in June did the momentum behind it become unstoppable. Then in November Harvey Pitt, the controversial chairman of the SEC, which is charged with putting much of the act into effect, resigned. He was followed by his choice of chairman for the five-member oversight board: William Webster, a former director of the CIA not overburdened with the “financial literacy” that the act stipulates for the job. The oversight board remains without a chairman, as does the SEC.

The act has also been widely criticised for its woolly wording. Frits Bolkestein, a European commissioner, says that it “has been drafted in a rush and it shows.” Signs of hurried drafting appear in the strange way in which it insists that foreign banks listed in America ban loans to their directors while, in effect, exempting American banks from the same requirement. Such anomalies may offer rich pickings for lawyers, who were also well rewarded by the act's requirement that chief executives and chief financial officers personally certify that their companies' “financial statements and disclosures fairly represent, in all material respects, the operations and financial condition” of the company.

All this, unfortunately, is unlikely to be enough to guarantee that accounts are, in future, any more “fair” than in the past. In this month's *Harvard Business Review*, in an article entitled, “Why Good Accountants Do Bad Audits”, Mr Bazerman, an experimental psychologist, explains how human bias gets in the way.

With his co-authors, George Loewenstein and Don Moore, Mr Bazerman maintains that people are hard-wired to act with “self-serving bias”. In a controlled experiment, 139 auditors were given five ambiguous auditing vignettes and asked to judge the accounting in each. Half were told to suppose they had been hired by the company they were auditing; half that they had been hired by another company that was doing business with it. For all five vignettes, the subjects were, on average, 30% more likely to find that the accounting behind the numbers complied with GAAP if they were playing the role of auditor to the firm. Similar degrees of bias have been found in comparable situations.

The authors note that “these experiments show that even the suggestion of a hypothetical relationship with a client distorts an auditor's judgment. Imagine the degree of distortion that must exist in a long-standing relationship involving millions of dollars in ongoing revenues.” Their conclusion is that auditors should be regarded “as more like tax collectors than partners or advisers.”

The view from elsewhere

Europeans began by being rather smug about Enron and its fall-out. It couldn't happen here, some suggested, because of Europe's different view of the purpose of accounts and of the role of chief executives. There are indeed big differences.

The British, for example, maintain that accounting is more art than science. British accounts include the auditor's subjective opinion that “the financial statements give a true and fair view of the state of affairs of the company and the group”. American auditors affirm that the accounts accord with GAAP rules—all 144 of them, each with pages and pages of intricate detail. Like overcrowded market towns, such objective rules are made to be by-passed. American lawyers are good at that.

The other big difference between Europe and America lies in their attitude to bosses. Americans like to appoint a man to the top job and let him get on with it. Europeans are more cynical, believing that those chief executives who are not power-crazed when appointed will soon become so. Left too much to their own devices, such people are, they fear, as likely to run off with the business as to get on with it.

In America, the jobs of chief executive and chairman are usually combined; in Europe, they are usually not. Sir Adrian Cadbury, chairman of a British committee that looked into corporate governance in the early 1990s (many of whose recommendations are now required of companies listed in London) wrote recently that “the jobs of chairman and chief executive demand different abilities and, perhaps, temperaments. It is very much in shareholders' interests to ensure they are performed by different people.”

Any smugness in Europe about Enron, however, has not lasted long. It has plenty of its own scandals to explain. Lernout & Hauspie, a Belgian manufacturer of voice-recognition software, “invented” millions of dollars of fictitious sales in South Korea. MyTravel, a big British holiday tour operator, was forced to restate its previous year's profits when its auditors, Deloitte and Touche, said that the accounting policies approved by their predecessor were “too aggressive”. No surprise, perhaps, that the predecessor was Andersen. And then there is Vivendi, a sewerage-to-films conglomerate that Jean-Marie Messier, its French boss, ran into the ground through a combination (familiar to Americans) of hubris and creative accounting.

Like America, Europe has responded with measures to improve corporate governance. The Germans have produced a legally binding corporate-governance code, to be reviewed once a year. In Britain, a committee under Derek Higgs, an investment banker, is expected to recommend that boards be more open about how they appoint non-executive directors. The EU published its own proposals in November, putting the responsibility for company accounts firmly on the shoulders of boards.

Europe may still have something to be smug about. A recent survey by the Economist Intelligence Unit, a sister company of *The Economist*, looked at the top ten companies by market capitalisation in several countries and judged how transparent they were on corporate governance—details of executive-pay schemes, how they chose their auditors, how they selected non-executive directors and so on. Top of the list came Germany, followed by France and Britain. America was next to last, beating only Japan.

The narrow focus of the response to Enron may blind companies to deeper issues. One is the blurring of the boundaries of the corporation. Both geographically and legally, companies are no longer the unified, self-contained organisations that they were. Through outsourcing, joint ventures and strategic alliances that stretch around the globe, they are coming to resemble loose networks of relationships. Most large

companies now have at least 30 alliances, and many have more than 100. Some are beginning to see the management of these networks as a key function—but you cannot often tell from reading their accounts.

At the heart of the Enron story sat the “special-purpose entities” that were kept off its balance sheet. But all sorts of corporate risks remain unrecorded in companies' accounts. In perfectly healthy Dell's accounts, for instance, there is no mention whatsoever of Taiwan. Yet almost all the semiconductors that go into Dell's computers are made by subcontractors in one earthquake-prone region of this politically sensitive country. Should Dell not tell investors about this?

Enron and WorldCom were seen to be largely about fiddling the figures in financial reports and rewarding executives excessively. The Sarbanes-Oxley act and other measures may lull investors into feeling that it is safe once again to go back into the water. But the real lessons to take away from Enron and WorldCom are that financial reporting can never be an exact science, and that managers will be as greedy as they can get away with. Investors will always need to be armed with scepticism and tough questions.

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Corporate crookery

The charges so far

Nov 28th 2002
From The Economist print edition

A little list, but getting longer

•**Enron**. In October, **Andrew Fastow,** former finance director, was charged with fraud and conspiracy. **Michael Kopper**, an assistant to Mr Fastow, pleaded guilty in August to charges of wire fraud and money laundering.

•**WorldCom. Scott Sullivan**, ex-finance chief, was indicted in August on charges of securities fraud and making false filings with the SEC. He pleaded not guilty. In September, **David Myers** pleaded guilty to similar charges. **Buford Yates**, ex-director of accounting, pleaded guilty to securities fraud.

•**Tyco**. New York prosecutors charged **Dennis Kozlowski** and his finance chief, **Mark Swartz**, with stealing more than $170m from the company and illegally obtaining more than $400m by selling shares. **Mark Belnick**, a former general counsel, was charged with six counts of falsifying records. All pleaded not guilty.

•**Adelphia Communications**. **John Rigas** and two sons have been charged with conspiracy to commit fraud.

•**Arthur Andersen**. The firm was convicted of obstruction of justice. One partner, **David Duncan**, has pleaded guilty to shredding documents.

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The economics of war

Calculating the consequences

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AP

Recent studies suggest that even a successful military campaign in Iraq could carry a hefty price tag

“IT SEEMS likely that Americans are underestimating the economic commitments involved in a war with Iraq,” says William Nordhaus, an economics professor at Yale University. Given all the imponderables surrounding such a war, it is surprising how many experts (like Mr Nordhaus) are trying to work out how much it might cost. After all, it is not clear whether Saddam Hussein's grip will crumble or if he might use weapons of mass destruction. And it is anybody's guess whether OPEC countries will replace any lost Iraqi production—or might slash output in a general Arab boycott.

The findings of the most ambitious effort to date, undertaken by the Centre for Strategic and International Studies, an American think-tank, were unveiled this week in New York. Over the course of the past few months, CSIS has tapped experts from various fields to try and quantify the likely impacts of war. First, the group's military and geopolitical gurus defined four likely military outcomes: no war; a benign war that lasts four to six weeks; a thornier intermediate option that lasts up to three months; and a “worse” case that drags on for as long as six months. The group intentionally set aside still worse possibilities, such as the use of nuclear weapons.

For each of these options, oil-market analysts convened by CSIS speculated over the likely path of oil prices. Their predictions were then fed into macroeconomic models that took into account the positive inputs, such as higher government spending, as well as the negative ones, such as higher inflation. They also factored in the role of market psychology, recalling the experience of the 1970s when oil shocks were accompanied by hoarding and panicky behaviour.

The group reached some striking conclusions. For a start, the no-war scenario is not necessarily the best for the economy. That is because lingering uncertainty about a possible war will continue to depress markets and add a risk premium that boosts oil prices and acts as a drag on growth. At the other extreme, if things turn ugly, the team predicts that oil prices could spike up to $80 a barrel and, more damaging in economic terms, stay at around $40 for many months thereafter (see chart).

In the end, though, the group's assessment of the cumulative cost of war to the end of 2004 is not overly alarming: about $55 billion in the benign scenario, and around $120 billion in the worse-case scenario. (The higher numbers in the table below are for a whole decade.) The Congressional Budget Office and a committee of the House of Representatives have also

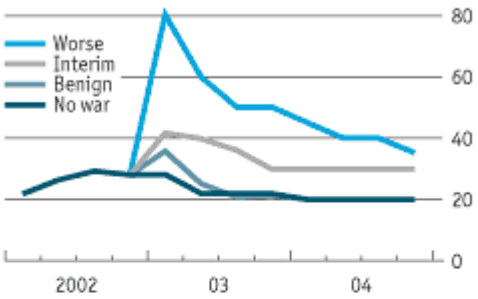
done some sums, and both came up with estimates of $50 billion-60 billion for a shortish war. The Gulf war cost about $80 billion in today's money, although much of that was recouped by contributions from Saudi Arabia and other allies, which are not likely to be repeated this time. Even so, America can afford all the scenarios.

Some even suggest that the war could be an economic boon. Most wars in America's history have—thanks to massive government spending on defence—tended to stimulate the economy. A notable exception to that, however, was the Gulf war, which was followed by recession. Even so, say some extreme imperialists, if Saddam Hussein is ousted, then America will be able to turn Iraq into its own private pumping-station. Private or not, higher Iraqi output would mean that oil prices would drop for a while and America's economy (along with other oil-consumers') would benefit.

Larry Lindsey, a top economic adviser to President George Bush, made precisely this argument recently: "When there is a regime change in Iraq, you could add 3m-5m barrels of production to world supply...successful prosecution of the war would be good for the economy." The snag in this rosy plan is the dilapidated state of Iraq's petroleum infrastructure: oilmen say it would take 5-10 years for Iraqi output to reach such unprecedented levels (even assuming a post-Saddam Iraq would actually want to flood the world market with oil). Mr Lindsey offered an even more cheerful forecast: he estimated that even a prolonged war would not cost more than $100 billion-200 billion, or about 1-2% of America's GDP.

Over a barrel

Price of crude oil (West Texas Intermediate)
$ per barrel, scenario:



Estimate of cost of war with Iraq to the US*
$bn

	Low†	High‡
Direct military spending	50	140
Follow-on costs:		
Occupation and peacekeeping	75	500
Reconstruction & nation-building	25	100
Humanitarian assistance	1	10
Impact on oil markets	-30	500
Macroeconomic impact	0	345
Total:	**121**	**1,595**

*Total for the decade following the conflict (in 2002 $)
†Short & favourable ‡Protracted & unfavourable

Sources: Centre for Strategic and International Studies; William D. Nordhaus, Yale University

What's the worry, then?

Hang on a minute, says Mr Nordhaus, who argues in the latest *New York Review of Books* that none of the recent analyses of war goes far enough. In general terms, he agrees with their estimates for the direct military costs for the various scenarios. But he insists they underestimate the long-term costs to America from an Iraqi war.

He points to the high costs likely to be incurred after a military victory is secured: eg, in peacekeeping, reconstruction and nation-building. Mr Bush has openly committed America to rebuilding Iraq after ousting Mr Hussein. By examining international experience in post-war Kosovo, East Timor, Haiti and other recent cases, Mr Nordhaus estimates that such non-military costs could reach $600 billion if a liberated Iraq turns out to be more like the West Bank than Kosovo.

He also worries that an Arab boycott or some other political factor could keep a significant share of OPEC oil off the market for many months. And that, of course, would mean higher oil prices, higher inflation, lost economic output, and so on. All told, Mr Nordhaus thinks that even an Iraqi invasion that went well would probably cost about $120 billion in today's money over the next decade—and one that went horribly wrong could end up costing a whopping $1.6 trillion.

The estimators differ in the purpose, methodology and sophistication of their analysis. But, taken together, recent prognoses point to one conclusion: even a short war will prove fairly costly, while a messy one could deal the economy a severe blow. Mr Bush has often stressed the possible price—in terms of national security—of not going to war against Saddam Hussein. These studies suggest that he should start preparing Americans for the economic costs of going to war as well.

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Bahraini banks

In the shadow of Saddam

Nov 28th 2002
From The Economist print edition

Bahrain's troubles could boost Dubai's ambitions

THE threat of war in Iraq is adding to the difficulties facing Bahrain's once-thriving offshore banking business. A number of western banks have slashed their exposure to the Middle East since it became clear that an American-led attack was a real possibility. The Bahrain Monetary Agency (BMA, the country's central bank) has been forced to prop up at least two Bahraini investment banks in recent months, after a string of downgrades by credit-rating agencies.

One of the banks, Bahrain International Bank (BIB) unveiled losses this week of $49m for the first nine months of 2002, stemming mainly from problems in its American portfolio. This followed BIB's default on loan repayments in late September. Creditors, including a number of European banks, agreed at the time to a 90-day standstill agreement. They are now reviewing a long-term refinancing package drawn up by Credit Suisse First Boston. Further discussions are scheduled for early December, after the religious holiday at the end of Ramadan.

At the same time, BIB is asking its shareholders for an additional $30m-50m from a rights issue. But the appetite of investors for new BIB equity has been low since the default was revealed. The announcement, in late October, that the Internal Revenue Service had seized some of BIB's American assets over a $26m tax bill has done little to restore their appetite.

Robin McIlvenny, BIB's chief executive, insists that the bank can pull through. The BMA agrees. “Recent external valuations indicate that BIB is solvent,” it says. Others are not so certain. “It is still in a delicate situation,” says Darren Stubing, chief bank analyst with Capital Intelligence, a rating agency. Earlier this month, Capital Intelligence downgraded another small Bahraini investment bank, BMB, which is also receiving central-bank support.

The timing could not be worse. With the launch of the Dubai International Financial Centre (DIFC), neighbouring Dubai is posing the most serious challenge to Bahrain's status as the region's investment-banking hub since the 1970s. A special legal and regulatory framework is being drawn up for the DIFC, and in September the winning design for what is to be its landmark building—a 15-storey “contemporary interpretation of the Arc de Triomphe”—was unveiled. A Bahraini banking crisis could give Dubai's financial ambitions a triumphal boost.

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French banking

Credit where it's due

Nov 28th 2002
From The Economist print edition

BNP Paribas swoops on Crédit Lyonnais

"I CANNOT imagine that a democratic state could sell such an important stake without any competition," declared Daniel Bouton, chairman of Société Générale, France's third-largest bank. Until last weekend, he had feared that the French government would sell its 10.9% stake in Crédit Lyonnais, the bank it rescued with public money in the 1990s, privately to Crédit Agricole, a big mutual bank that serves French farmers. But on the night of November 22nd, to general amazement, Francis Mer, finance minister, put the stake up for sale to whomever—including, in theory, foreign banks—could offer the highest price in 22 hours. BNP Paribas, France's largest bank by market capitalisation, carried off the prize.

By far the happiest with the auction's outcome is the government. Mr Mer had been content to pursue the plan of Laurent Fabius, his Socialist predecessor, to create a French national champion, by pushing Crédit Lyonnais into the arms of Crédit Agricole. But when Crédit Agricole refused to pay *euro*44 per share ($44), the lowest price he was prepared to accept, he lost patience. BNP Paribas, the auction's winner, bid *euro*2.2 billion, or *euro*58 a share, for the stake, a 49% premium over the market value and a quarter more than the next-highest bid. Advisers to Mr Mer joked that BNP Paribas's bid document must have contained a typing error.

The losers from the sudden sale are Crédit Agricole and Crédit Lyonnais's chief executive, Jean Peyrelevade. Having refused to pay *euro*44 a share in a private deal, Crédit Agricole reportedly offered that amount in the public auction, only to lose. Part of the problem is that Crédit Agricole's decentralised, mutual structure makes it difficult for its "barons" in the countryside to agree on anything quickly.

Mr Peyrelevade, who wants to keep his bank independent, has so far maintained what one French banker calls a Soviet balance of power between the bank's biggest shareholders. As soon as one looms too large, he courts another. This time though, he miscalculated, stringing out his negotiations with Crédit Agricole to a point where Mr Mer stopped believing that the two banks had any real desire to merge.

Mr Peyrelevade now faces the likelihood that BNP Paribas or, just possibly, Société Générale, will bid for the whole of Crédit Lyonnais once a shareholder pact designed to protect the bank from takeover ends at the end of June 2003. Either bank would fold Crédit Lyonnais's wholesale banking business into their own operations. To avoid that, Mr Peyrelevade may have to run back to Crédit Agricole, which already owns 10.5%, with more conciliatory words than those of recent months.

For now, BNP Paribas denies that it intends to buy the whole of Crédit Lyonnais. But Michel Pebereau, its chairman, is unlikely to have paid such a high price for the stake unless he has designs on the whole. With Crédit Lyonnais in its grip, BNP Paribas would increase its share of the French retail banking market from 8% to 14%.

One likely opponent of any such move would be AGF, the French insurance subsidiary of Germany's Allianz, which owns about 10% of Crédit Lyonnais. French bankers are preparing themselves for a battle to echo the one that Banque Nationale de Paris (BNP), Paribas and Société Générale waged in 1999, which ended with BNP wresting control of Paribas. As one banker says, "BNP Paribas is usually the winner."

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Financial markets

Robo-traders

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Computerised trading agents may help humans build better markets

THANKS to slumping markets, investment banks are shedding many of their highly-paid traders. When markets recover, the banks might be tempted to replace them with rather cheaper talent. One alternative has been around for a while but has yet to catch on: autonomous trading agents—computers programmed to act like the human version without such pesky costs as holidays, lunch breaks or bonuses. Program trading has, of course, been done before; some blamed the 1987 stockmarket crash on computers instructed with simple decision-making rules. But robots can be smarter than that.

Dave Cliff, a researcher at Hewlett-Packard Laboratories in Bristol, England, has been creating trading robots for seven years. In computer simulations he lets them evolve “genetically”, and so allows them to adapt and fit models of real-world financial markets. His experiments have suggested that a redesign of some markets could lead to greater efficiency.

Last year, a research group at IBM showed that Mr Cliff's artificial traders could consistently beat the human variety, in various kinds of market. Nearly all take the shape of an auction. One well-known type is the English auction, familiar to patrons of the salesrooms of Christie's and Sotheby's, where sellers keep mum on their offer price, and buyers increase their bids by stages until only one remains.

At the other extreme is the Dutch auction, familiar to 17th-century tulip-traders in the Netherlands as well as to bidders for American Treasury bonds. Here, buyers remain silent, and a seller reduces his price until it is accepted. Most markets for shares, commodities, foreign exchange and derivatives are a hybrid of these two types: buyers and sellers can announce their bid or offer prices at any time, and deals are constantly being closed, a so-called “continuous double auction”.

Mr Cliff's novel idea was to apply his evolutionary computer programs to marketplaces themselves. Why not, he thought, try and see what types of auction would let traders converge most quickly towards an equilibrium price? The results were surprising. In his models, auctions that let buyers and sellers bid at any time—like most of today's financial exchanges—were less efficient than ones that required relatively more bids from either buyers or sellers.

These “evolved auctions” also withstood big market shocks, such as crashes and panics, better than today's real-world versions. Mr Cliff's most recent results, which will be presented in Sydney, Australia, on December 10th, show that the best type of auction for any market depends crucially on even slight differences in the number of buyers and sellers.

Bank of America has been investigating these new auctions, along with robotic traders, for possible use in electronic exchanges. The hope is that today's financial auctions and online marketplaces might work better by becoming more like their English and Dutch forebears. But what to call such multi-ethnic hybrids? Here's introducing the “Cliffhanger”.

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Japanese life insurers

No policy is the best policy

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The condition of Japan's life-insurance industry is not improving

SIX Japanese life insurers have gone bust in the past three years. Like their counterparts elsewhere, Japanese firms are locked into unprofitable long-term contracts. Sold in the bubble years, these promise to pay high rates of return, far above what life insurers can earn at a time of ultra-low interest rates and deflation. On November 26th, the top seven Japanese insurers showed that they have still found no way out of this dilemma. They predicted that they would lose ¥1.1 trillion ($9 billion) in the year to March 2003—extending a decade-long run of losses.

Policyholders are responding by cancelling policies, putting fresh pressure on the insurers. But they may soon have even more to worry about. The industry's policyholder-protection fund, set up in 1999 with ¥560 billion of contributions from the industry and a promise of another ¥400 billion of public funds (for a limited period), is about to run out of money. Most of the industry's funds have now been used up, while the state's portion expires next March. The government must decide whether to extend its contribution by the end of December, when it draws up its budget for the next fiscal year.

Life and near-death
Japanese top seven life insurers

	Unrealised gains/losses on domestic equity portfolios, ¥ bn		Operating profits, ¥ bn
	30/3/02	30/9/02	Mar-Sept 02
Nippon Life	1,722	1,048	265
Dai-ichi Mutual	379	31	176
Sumitomo Life	-283	-384	134
Meiji Life	306	132	121
Yasuda Mutual	-33	-84	90
Mitsui Mutual	-144	-230	53
Asahi Mutual	-106	-211	29

Source: Company reports

The life insurers are bracing for a big fight. Regulators want them to contribute more in return for an extension, something the battered industry can ill afford. Some officials point to new bankruptcy laws, which have allowed the latest three collapsed insurers to find buyers for their operations quickly, bypassing the protection fund. Industry folk say this does not mean that fresh bankruptcies will be resolved as swiftly, especially if they are of bigger insurers. Besides, they add, an empty protection fund could further erode confidence.

One reason why the government may find it hard to be tough is that the life insurers have linked their fortunes to the big banks, which are also in a terrible state. Life insurers prop up their solvency margins—measures of their capital adequacy—by turning to banks for loans. In turn, they help out the banks by lending them money and buying their shares.

Take Sumitomo Life, the third-largest life insurer, and Mitsui Mutual, the seventh; both have close relationships with Sumitomo Mitsui Banking Corporation (SMBC). According to the Japan Centre for Economic Research and Mitsuhiro Fukao of Keio University, at the end of March SMBC had provided ¥150 billion-worth of funds to the two insurers. It is also thought to have lent up to ¥760 billion more in subordinated debt, pushing its exposure to the two to some 16 times its net profit. The two insurers, in turn, held about ¥160 billion-worth of the bank's shares.

Other life insurers and banks have similar relationships, which is why many people worry that a big bankruptcy in the life-insurance industry could bring down a bank, and vice versa. That might be why regulators and politicians are mulling over an idea that would help the life insurers by forcing them to lower their guaranteed rates of return. But this would be tantamount to a default, says Standard & Poor's, a credit-rating agency.

What is more, such a proposal would not be easy to implement. Nippon Life, the biggest life insurer, bitterly opposes the plan. With most Japanese owning several life-insurance policies each, the proposal would also be hugely unpopular. Besides, asks Mr Fukao, why should policyholders, who in bankruptcy

proceedings have precedence over subordinated-debt holders, lose out first?

In any case, the government needs to tread carefully. Past experience has shown that its efforts, even though well-meant, often end up highlighting the industry's woes and scaring off customers. For the life insurers right now, that may be the deadliest threat of all.

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Japanese safes

Take it or break it

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A novel form of theft in Japan

STEALING safes used to be a fiddly business that involved cracking combinations or prising open doors. No longer. In Japan thieves simply take the whole thing. Resourceful crews, using a jack, a pushcart and a truck, are making away with huge safes, weighing as much as several hundred kilograms. The safes are taken to dumps and other lonely areas, where they are opened—mostly with hydraulic excavators swiped from nearby building-sites.

Such robberies have been rising over the past year or so. Anecdotal evidence suggests that dozens of safes in and around Tokyo are whisked away each month. Elsewhere, two sushi stores, both part of a popular *kaiten zushi* (conveyor-belt sushi) chain in Yamanashi, were hit on the same night, losing two hefty safes containing ¥2.6m ($21,310). A 100-kilo safe containing ¥1.4m was stolen from a golf range in Hyogo. A post office in Kobe lost a 200-kilo vault filled with ¥160m in stamps and cash.

The gambit appeals because stealing a safe takes less time than stealing its contents. Robbers do not have to worry about sophisticated alarm systems monitored by high-tech security companies, since they can cart off a big vault in three or four minutes—less time than it takes even the quickest security firm to respond. Cockier gangs even make off with automated teller machines (ATMs).

Thieves breaking into a video arcade in Saitama added a new twist to this increasingly popular way of pulling off a heist. They threw the arcade's 300-kilo safe out of a window. The two-floor drop broke the safe open—and the thieves walked away with ¥5m.

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The Zoellick plan

Trading insults

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America wants a duty-free world. Almost

THE past year has been lousy for free trade. The Americans have ratcheted up farm subsidies and slapped new import duties on foreign steel. A European summit made little progress towards reform of the common agricultural policy (CAP); indeed, the French managed to secure agreement to preserve CAP spending at present levels. Poor countries are despairing over the outlook for the Doha round of trade negotiations, which was intended to benefit them. Just this week, negotiations between rich and poor countries over access to patented drugs through "compulsory licensing", a big aim of poor countries, stalled.

But just as the world seemed headed towards 1930s-style protectionism, along comes a repentant America with a bold new plan to eliminate all tariffs on trade in WTO countries' manufactured goods by 2015. The proposal, put forward by President Bush's trade representative, Robert Zoellick, is simple but ambitious. By 2010, WTO members would reduce all tariffs to below 8%, and scrap altogether those that are now less than 5%. By 2015, all tariffs on manufactured goods would be reduced to zero. At minimum, the proposal is a welcome multilateral gambit by the Bush administration, which has recently seemed content to cut its own bilateral deals with countries in Asia and Latin America, working outside the WTO.

Sadly absent from the plan is any more discussion of farm goods, which form the basis of the poorest countries' economies. Admittedly, in July Mr Zoellick put forward a proposal to scrap many farm subsidies, but there is little sign that American farmers will support this. Rich countries' tariffs on factory goods are already low—typically less than 5%—while their subsidies and tariffs on farm goods are in general far higher. Duties on poor countries' manufactured goods are quite high, in an effort to protect their domestic industry.

Until bigwigs in Brussels and Washington are ready to outface their cosseted farmers, Mr Zoellick's tariff-cutting plan will go nowhere

To be sure, poor countries' consumers would gain by opening their borders to goods from other poor countries. But more immediately, their budding manufacturing industries would suffer—a fate that is politically unacceptable to the biggest traders—and under Mr Zoellick's plan poor countries would get little in exchange.

Pascal Lamy, Mr Zoellick's opposite number in the EU, was unimpressed by the move; the European Commission called the plan unrealistic. Europeans would rather reduce only the highest tariffs than move quickly toward an overall elimination. That may be because they have even more to lose than America from a reciprocal agreement to end farm subsidies—and, unlike Mr Zoellick, they have not even put forward a proposal for farm trade in the Doha talks. Supachai Panitchpakdi, the Thai director-general of the WTO, wrung his hands over the pain that the Zoellick plan would visit on poor countries.

America's farm bill and the EU's failure to agree on CAP reform are making a mockery of the idea that the Doha round was to be a "development round". If poor countries are to accept any version of the Zoellick plan, they will press for much greater access for their farm products. Until bigwigs in Brussels and Washington are ready to outface their cosseted farmers, Mr Zoellick's tariff-cutting plan will go nowhere.

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Russian banks

Safer than mattresses?

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Reform is slowly getting under way

UNDER the mattress may soon stop being the safest place for a Russian to keep his cash. This week the government was due to send parliament a bill to create a deposit-insurance scheme for banks. Richard Hainsworth, an analyst at Renaissance Capital, a Moscow investment bank, says the bill is “the one that should transform the banking system”.

Of course, all may not go according to plan. The proposal has been around for at least eight years, and the bill looked like being held up at the last minute by a spat over who would manage the scheme's fund (and pocket the transaction fees). However, since the central bank's management was changed in March, reform has gained momentum. Earlier this autumn, parliament passed a law that, among other things, makes it easier for lenders to secure the collateral against unpaid loans.

Russians distrust banks, especially since the 1998 crash in which many closed their doors. The one they do trust dwarfs the rest: the mainly state-owned Sberbank, which holds around 70-80% of retail deposits. Sberbank has a state guarantee behind its deposits—at least in theory (the legal mechanism for it is dubious). The new scheme, to be phased in over nearly four years, aims both to boost confidence and to promote competition. It would abolish Sberbank's guarantee and create a single fund into which all banks would put 0.15% of their deposits. If a bank fails, its depositors would get back everything up to 20,000 roubles ($630) and 75% up to 120,000 roubles—not a lot, but enough to give poorer savers some peace of mind.

The scheme's detractors argue, albeit with a touch of sophistry, that it actually makes banking riskier. By covering a limited share of all bank deposits, instead of the full amount of just Sberbank's deposits, it will protect 42% of all money in the system, instead of over 70%. As for competition, Andrei Ivanov of Troika Dialog, another investment bank, comments that “we do not expect a flow of deposits from Sberbank to commercial banks as there is currently little overlap in their classes of depositor.”

Sberbank's chief competitors, both Russian and foreign, make their money by concentrating on the better-off, people who need more sophisticated services such as loans and investment advice. Citibank, which started retail operations in Moscow only last week, is marketing itself to professionals who will enjoy checking their accounts online and getting transaction alerts on their mobile phones.

For such banks, deposit insurance may be welcome, but other reforms matter more. Maciej Lebkowski, head of retail business at Alfa Bank, a Russian commercial bank, says that this year's big achievement was persuading the central bank to change its nit-picking rules requiring tellers' desks to be built like nuclear bunkers. Alfa is about to open a sleek new branch that resembles not so much a bank as an Internet café. Further discouragement to would-be depositors comes from transaction taxes that mean they have to pay a fee to take money out of the bank, even from their own branch. As long as that remains the case, some Russians may prefer the risk of night-time robbery under the mattress to daylight robbery over the counter.

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Economics focus

The Zimbabwean model

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The pros and cons of opting out of the global economy

Get article background

ORTHODOX economists sometimes get it wrong. For example, when a government fixes the prices of various goods below what they cost to produce, and fails to provide the necessary subsidy to fill the gap, orthodox theory predicts that there will be empty shelves in the shops. But in Zimbabwe, this is not how things have turned out. Retailers there have indeed run out of all manner of price-controlled goods. But for some reason they can still get hold of toilet paper. So, instead of empty shelves, Zimbabwean shoppers encounter aisle upon aisle of roll upon roll, where the bread, sugar and oil used to be.

Ignore, for a moment, the headlines about murder, torture and election-rigging. For an interesting economic experiment is being conducted in Zimbabwe. To the foes of globalisation, President Robert Mugabe's views are unexceptional. He argues that “runaway market forces” are leading a “vicious, all-out assault on the poor”. He decries the modern trend of “banishing the state from the public sphere for the benefit of big business.” What sets him apart from other anti-globalisers, however, is that he has been able to put his ideas into practice.

In countries where the IMF calls the shots, governments have to balance their budgets on the backs of the poor. Having told the IMF to get stuffed, Mr Mugabe is free not to do this. The official estimate is that Zimbabwe's budget deficit will be about 14% of GDP this year; the government is frantically borrowing and printing money to cover the shortfall. Inflation is now 144%, and it is predicted to top 500% next year.

Mr Mugabe argues that price rises are caused by greedy businessmen. His solution is price controls. For the past year or so, these applied only to everyday essentials, such as bread and maize meal. Shops were ordered to sell such goods at fixed, low prices. Unfortunately, Mr Mugabe was right about those greedy businessmen. Rather than lose money, they stocked their shelves with toilet paper, or tried to dodge price controls by modifying their products. For example, since bread was price-controlled, bakers added raisins to their dough and called it “raisin bread”, which was not on the list. Not to be outsmarted, on November 16th the government extended price controls to practically everything, from typewriters to babies' nappies.

Some things have to be imported, however, and it is hard to prevent foreigners from profiteering. Mr Mugabe is anxious that petrol, for example, should be affordable; otherwise, people will not be able to get to work. A strong currency should help, so he has frozen the exchange rate for the past two years, and denounced as a “saboteur” anybody who suggests devaluation. Since Zimbabwe's inflation is a tad higher than America's, nobody wishes to surrender hard currency at the official rate of 55 Zimbabwe dollars to one American dollar. The black market rate is several hundreds to one; the government blames speculators.

To lay hands on foreign currency, Mr Mugabe has no choice but to rob exporters. Those whose products are bulky and hard to smuggle (tobacco farmers, for instance) must surrender half of their hard-currency proceeds to the government, which repays them in crisp new Zimbabwe dollars, at the official rate.

This is not nearly enough, however, to keep Zimbabwe supplied with petrol (the distribution of which is a state monopoly). So, this month, the finance minister announced a clampdown on the black market: all bureaux de change are to be shut. He also asked expatriate Zimbabweans to remit money home via the central bank, which will confiscate almost all of it. For some reason, they prefer informal channels, such

as Internet-based firms that accept cash offshore and issue friends and relatives back in Zimbabwe with local currency or vouchers for supermarkets.

For most problems, a coercive solution can be found. The government's debt-servicing costs are too high? Force financial institutions to buy treasury bills that yield far less than the rate of inflation. People are running out of food? Confiscate grain from those who have it (“hoarders”) and distribute it at an artificially low price through a state monopoly grain distributor. Ordinarily, this would somewhat dampen commercial farmers' incentive to grow food. But since most of them have been driven off their land, what does it matter?

An example to us all

It would be nice to think that the rest of the world has nothing to learn from Zimbabwe. But Mr Mugabe has many admirers. His fellow Africans cheer his defiance of the old colonial powers. Namibia's government has promised a similar land-grab. South Africa, showing comparable paranoia about currency speculators, recently conducted a pointless investigation into whether banks had conspired to undervalue the rand.

Globally, few policymakers favour going the full Mugabe, but many believe that a little bit of price-fixing won't hurt. Price supports for EU farmers, for example, persist because their governments are rich enough to keep subsidising them, and because the costs are spread across the entire population, who are often unaware that they are being fleeced. Influential charities argue that poor countries should also be paid a “fair” price for their products. Oxfam, for example, contends that the price of coffee is “too low” because multinationals manipulate it. The charity is campaigning for it somehow to be raised.

It may seem harsh, when faced with the misery of an Ethiopian coffee farmer, to argue that it would be more efficient to let the price mechanism deliver its message (“Grow something else”) unmuffled. But greater efficiency leads to greater wealth, and vice versa, as Zimbabwe so harrowingly shows. Nowhere has withdrawn so swiftly from the global economy, nor seen such a thorough reversal of neo-liberal policies. The results—an economy that has contracted by 35% in five years, and half the population in need of food aid—are hard to paper over.

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Biological weapons

Hide and seek

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Remote detection of bioweapons will soon be useful in the event of an attack

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A FEW days after being infected with ebola, patients begin to notice that something is wrong. Headaches, fevers and chills are followed by diarrhoea, vomiting and internal and external bleeding, leading to the death of most of those infected. Other virulent diseases have similar effects; poisonous chemicals can kill even more quickly, although they are not contagious. When grouped with nuclear weapons in the antiseptic abbreviation WMD—weapons of mass destruction—it is easy to forget just how devastatingly nasty biological weapons can be. T.S. Eliot perhaps put it best when he said, “I will show you fear in a handful of dust.”

Secret agents

Until recently, anybody who found a handful of suspect dust could see little more than fear. Identifying exactly which “bioagents”—biological agents such as ebola, anthrax, or harmless bacteria—were in a sample could be done only in a laboratory. A portable bioagent-detection system would thus be a great boon to weapons inspectors.

At the forefront of military research in this area is America's Defence Advanced Research Projects Agency (DARPA). Some of its projects imitate the human immune system so as to create an artificial sensor. Others are based on microchips that amplify the DNA of suspected bioagents and then compare the results with those of known pathogens. Also in development are portable versions of the equipment that is now being used to identify biological weapons in the laboratory.

These systems are speeding up the detection of bioagents in the field. But point detection systems will always be of limited use. They do not help the person using the sensor to avoid the bioagent; and it is hard to inspect a large region. However, technology for detecting bioagents from a distance is now coming into its own.

The first such technology is called hyperspectral imaging. Electrons orbit atomic nuclei at specific distances from the centre of the atom. This means that atoms can absorb light only at certain energies. So when atoms reflect light, there is a characteristic pattern of absorption lines that is specific to any given substance. If this incoming light is then examined, these lines reveal exactly what sort of stuff is being observed. This is the principle behind hyperspectral imaging.

Satellites and aircraft can now gather the necessary high-resolution images of the earth, and analyse the light reflected from the ground. The prodigious computing power that is necessary to analyse data arriving at a rate of 30 megabytes per second has only recently become available. Now that it has, hyperspectral imaging is also becoming a valuable commercial tool. It is already used to prospect for minerals and to check crops for disease from a distance. It can, in theory, also be used by the authorities to search for and identify cannabis or opium crops.

Many companies specialising in hyperspectral imaging have sprung up in the past five years. Some of these, including the Galileo Group, located in Melbourne, Florida, also work for the armed forces.

Hyperspectral imaging of visible light can pick out camouflaged man-made objects from surrounding natural ones. In the infra-red, hyperspectral sensors can detect vapours of chemical and biological weapons in the air. Although Michael Barnes, head of Galileo, will not comment on specific military programmes, it seems clear that an aircraft equipped with hyperspectral sensors would be useful for detecting hidden bioweapons laboratories. This would include, for example, the trucks rumoured to be driving around Iraq that may produce inadvertent emissions of trace amounts of bioagents.

Also in development, is another potentially useful technology known as light detection and ranging (LIDAR). LIDAR works in the same way as RADAR, by bouncing radio signals off a target and analysing the results. Because LIDAR works at higher frequencies, the tolerances of the hardware involved must be much more precise. This means that the system is much more difficult to build.

One type of LIDAR—known as differential LIDAR—may be especially suited to detecting biological and chemical agents. It sends out two almost simultaneous pulses of light. Because the two pulses are of slightly different wavelengths, one will be absorbed by bioagents, while the other will not. By measuring the comparative strengths of these reflections, the composition of a cloud of vapour can be worked out. LIDAR has been used in satellites by America's space agency to analyse the atmosphere for such things as ozone depletion. The American armed forces have several LIDAR systems in development and plan to start producing Artemis, a field-deployable LIDAR, in 2005.

Even these increasingly sophisticated systems for distance-sensing, however, have difficulties sorting out the particular signature of bioagents from the background muddle, especially when the concentration of bioagents is small. This problem is being looked at by Michael Sailor and his colleagues at the University of California, San Diego. The team are also working on a “smart dust”. This will counter the malignant dust of biological and chemical weapons.

In a paper in the October issue of *Nature Materials,* Dr Sailor describes how to manipulate tiny, micrometre-sized, chips of porous silicon so that they bind to a specific compound, for example sarin gas, a nerve agent. Because their structure is well understood, any change that comes from binding chips to a suspect biological compound can be detected by scanning it with a laser, rather as a bar-code scans groceries. So far, tests have been made using the laser only a few hundred metres off; but with a higher-powered laser, distances of at least a kilometre should be possible.

The technology to detect biological and chemical weapons seems to be progressing to the point when it will soon be able to provide sufficient warning to military forces deployed in the field. Protecting civilian populations requires a substantially different approach (see article). Because so much of the work is classified, though, it is difficult to say to what extent remote sensing might prove useful for detecting bioweapons in hidden laboratories.

For this reason, Trevor Findlay, executive director of the Verification Research, Training and Information Centre, a British think-tank, emphasises that old-fashioned techniques are still more useful to weapons inspectors than high technology. Because a lot of biological equipment is dual-use, there is no substitute for extensive interviews with personnel and systematic tracking of the paper trail. Nevertheless, technologies that are on the verge of being realised may help to show inspectors where to look and, in the dreadful event that biological weapons are actually used, may prove valuable for organising a sound response.

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Biological terrorism

The spores of war

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The world has only just woken up to the threat of bioterrorism. And only America has yet done much to prepare for it

SIX days before the terrorist attacks of September 11th last year, Joseph Biden of Delaware told Senate hearings that the threat of biological attack on America dwarfed the dangers posed by missiles. Shortly afterwards, his colleagues Thomas Daschle and Patrick Leahy, along with various journalists, were the targets of just such an attack, when letters containing anthrax spores were delivered to their offices through the ordinary post. Five people died after exposure to spores that had leaked from the envelopes, scores more were infected, and strong antibiotics were pumped into thousands who might have been exposed.

Biological weapons—whether the sophisticated products of a national military programme, or the crude poisons of a biological Unabomber—sit at the lower end of a spectrum of biological threats to health. At the higher end sit naturally occurring epidemics of familiar diseases such as influenza, which still sweeps the world each year, and AIDS, which has so far killed 22m people. In between lie re-emerging and previously unidentified diseases, such as ebola or West Nile virus; industrial accidents or sabotage, by which bugs get out of laboratories; and growing resistance to antibiotics. On November 12th, a hospital in Detroit reported the first American case of staphylococcus (a potentially deadly infection) that is resistant to vancomycin, the strongest antibiotic in doctors' arsenals.

Compared with all these, biological weapons are a much more unlikely danger. Nor are they always simple to use. Aum Shinrikyo, a Japanese cult that carried out an attack with sarin nerve-gas on the Tokyo underground in 1995, had earlier experimented with anthrax, to little effect. The anthrax spores sent through the mail in America were a much more virulent strain and were finely milled, making it easier for them to penetrate the lungs of their victims. Prevailing weather conditions, such as wind speed, can interfere with the most diabolical planning.

Nonetheless, bioweapons have a fearful potential that has long been understood, ever since plague-ridden corpses were catapulted into the besieged city of Caffa by Tartars in 1346. Modern biological agents are far more lethal than even the most toxic chemical agents. In the 20th century most of the large military powers developed biological weapons, but moral repugnance and doubts about their military value largely kept countries from using them against each other.

This reluctance was formalised in the Geneva Protocol of 1925 and a Biological Weapons Convention signed in 1975, after America had renounced its programme, but as many as 17 countries are thought to have kept up some sort of capability. Troublingly, all seven countries on America's list of states that sponsor terrorism—Cuba, Iran, Iraq, Libya, North Korea, Sudan and Syria—are among the suspected dabblers. So far, none of the regimes thought to possess them is known to have passed on bioweapons

to a terrorist group, though no one really knows.

When the UN weapons inspectors were thrown out of Iraq in 1998, they had already destroyed thousands of litres of anthrax and other germ agents; but a whopping 17 tonnes of imported medium for growing germs were still unaccounted for. Iraq is since thought to have developed mobile germ laboratories, with others concealed under hospitals and private homes. It is also known to have adapted crop-sprayers to spread biological agents, and to have experimented not just with bacteria but with viruses, such as camel pox. It may (along with North Korea) have stocks of the smallpox virus.

Smallpox merits particular attention because it is the only disease that has ever been eradicated in nature. The last case was in 1979, and most people are now “immunologically naive”—as vulnerable to infection as America's Indians were to the poxes of the old world. America and Russia agreed to keep samples for research, and a few rogue regimes are thought by the CIA to have kept them for use as weapons.

“Dark Winter”, a government study completed in June 2001 that modelled the effects of a smallpox attack on three American cities, concluded that within two months there would be 1m dead and twice as many infected. America has rapidly secured enough doses of vaccine to inoculate the entire country and now wonders whether to do so. In the next few weeks, President George Bush is expected to announce a plan to vaccinate 500,000 health workers, with up to 7m-10m to follow. Other countries, too, are accumulating vaccine and wondering how many to inoculate (see article). In every million people given the smallpox vaccine, two or three may die and hundreds will suffer serious side-effects.

Spotting the symptoms

The anthrax letters sent last year were spotted by a Senate staffer who had recently undergone security retraining. Without such luck, or if an attacker were to release pathogens more surreptitiously, there would be as little immediate sign of an attack as of the arrival of the 'flu season. Early detection is crucial. Guarding places at risk may require devices that continuously monitor the air, sniffing for spores and other particles. Several different research groups are looking for antibodies that bind to the surface of biologically threatening molecules, fitting like a key in a lock, which could be the basis of both detection and treatment.

The more likely first sign of an attack or epidemic, however, will be the eruption of illness in people exposed to it. Spotting such a flare-up is the job of regional public-health offices that monitor reports of unusual symptoms from doctors. If something unusual crops up in the United States, samples are sent to one of the 158,000 state and local laboratories that can do biological culture analysis to identify the disease. The system needs to be expanded to collect other data that could give early warning of something out of the ordinary, such as sales of cold and 'flu medicine in chemists, or calls to emergency services with complaints of respiratory problems. New York has built a network to look out for sudden spikes, but most of the country has made little progress.

In America, the public-health system is anchored in the Centres for Disease Control (CDC) within the Department of Health and Human Services (DHHS). A bioterrorism-preparedness bill passed in the aftermath of the anthrax letters allocated $1.1 billion to the DHHS, with most of that going to the CDC and the rest to the Health Resources and Services Adminstration, which oversees hospitals round the country. The money will go towards the regional laboratory system and the health-alert network that allows doctors to communicate news of isolated cases to epidemiologists. Technicians are being trained to recognise unfamiliar pathogens. Hospitals and clinics have been given reference cards listing unusual symptoms and what precautions to take when they appear.

The CDC also manages a national pharmaceutical stockpile. This store of antibiotics, vaccines and other drugs is spread around eight centres to ensure that emergency medical supplies can be rushed to anywhere in America within 12 hours. The stockpile also has a “virtual” component, consisting of arrangements with manufacturers to boost production of particular drugs at short notice.

What goes into the stockpile and what tests the surveillance network can perform depend on research. The National Institute of Allergy and Infectious Diseases, one of the National Institutes of Health, has received the largest budget increase ever to go to one of the institutes. With its $1.75 billion budget for 2003, the institute plans to spend $521.1m building new laboratories secure enough to house the most dangerous pathogens. Basic research, including genomic sequencing of agents, will consume $440.6m.

Another $591.9m will go on discovery and development of drugs, vaccines and diagnostic techniques. Clinical trials—testing these techniques and medicines on people—account for the remaining $194.3m.

Tangled command chains

The rest of the DHHS money is earmarked for hospital planning. Years of underfunding of public hospitals and the efficiency drives of the private sector mean that hospitals do not have the “surge capacity” to cope even with a heavy 'flu season, let alone a wave of smallpox cases. A report published in October 2000 by the Stimson Centre, a think-tank in Washington, DC, was highly critical of the state of the public-health network. Amy Smithson, its author, argues that the state grants being given out by the CDC still do not reach deeply enough to the local level, where both detection and response first occur.

The interaction between local, state and federal authorities in America becomes even more fraught in an actual emergency, and clear lines of command are only just emerging. The creation of the Department of Homeland Security should consolidate some of the overlapping responsibilities. The CDC has also made an effort to clarify the lines of authority.

Constitutionally, protection of public health is a matter for the states. Some, such as Colorado, had developed bioterrorism plans before September 11th 2001. To encourage the others, and to introduce some consistency across the country, the CDC commissioned the law departments of Georgetown and Johns Hopkins Universities to create a model act designed to give states the necessary powers to detect and contain sudden outbreaks of disease.

The model act includes strict quarantine powers, and establishes the governor's right to declare a state of emergency in which public-health officials gain the authority to order doctors to treat people, and people to accept treatment on pain of arrest. Civil libertarians think these powers are dangerously broad, and should be replaced merely with clear instructions to which the public would probably respond. But widespread panic may make firm orders necessary.

Out of rogue hands

The other vital tactic is to stop terrorists getting hold of the germs to make bioweapons. In the past, extremist “patriot” militias have bought pathogens from commercial laboratory suppliers, and national weapons programmes such as Iraq's have also bought them on the open market. The Bioterrorism Preparedness Act has tightened the regulations for scientists working with a list of 42 “select agents”, which the CDC will update on December 9th. Every place that uses the agents has to compile a complete list of stocks and track everything that is done with them.

Terence Taylor, the head of the Washington, DC office of the International Institute for Strategic Studies, argues that this is inadequate. New genetic techniques mean that firms that deal with dangerous organisms can often avoid the effort and expense of shipping select agents by ordering instead two separate kinds of harmless genetic material that can then be combined to make up a dangerous bug. Terrorists might do the same. Unlike the nuclear or even chemical industries, where certain materials or pieces of equipment have narrow military uses and can be controlled, the life sciences deal in raw materials that are widely found in nature.

Industry must therefore take more care to see that its creations are not used to do harm. Taking a lesson from the nuclear industry, which formed a world association after the accidents at Three Mile Island and Chernobyl, the IISS, along with the Chemical and Biological Arms Control Institute in Washington, DC, is designing a charter for the biotechnology industry. The aim is to build a forum in which the industry's leaders can discuss new developments, share information about risks and threats, and agree on a code of practice.

A parallel project at IISS, in collaboration with Lawrence Livermore National Laboratory in California, is considering setting up an expert panel from industry and academia to spot evolving areas of risk in the biological sciences. A research group in Australia, for example, has modified the gene of the bacterium that causes mousepox, a cousin of smallpox, so that the disease is no longer blocked by its vaccine. The American Society of Microbiology, which published the mousepox paper, has introduced a policy of challenging the authors of provocative papers to consider their wider implications.

Plenty of scientists have squared work on bioweapons with their consciences in the past, and 9,000 of them used to work in the Soviet biological weapons programme. Keeping them out of the world's arms bazaars is the task of the International Science and Technology Centre, which was set up to provide non-military opportunities for former Soviet weapons scientists. So far it has spent $482m, 23% of it on biotechnology projects. The G8 summit earlier this year agreed to step up spending to guard Russia's biological materials and skills, as well as its chemical and nuclear ones.

Unlike the treaties outlawing the spread of nuclear and chemical weapons, the Biological Weapons Convention has no means to check that countries which sign up then keep their promises. As yet, there is no reliable way of doing so (see article). Attention is now concentrated on encouraging governments to beef up national legislation and on strengthening national and international health-surveillance systems. (A new Global Emergency Outbreak Response Fund is being set up under the auspices of the World Health Organisation, but funded in part by the Nuclear Threat Initiative, a private American foundation.) The Australia Group, an informal cartel of like-minded governments that tries to control the trade in dangerous chemicals and pathogens and the equipment to produce them, has recently drawn up tougher export controls, which also cover the transfer of know-how and information. But germs and viruses, as every 'flu outbreak shows, have a way of keeping one jump ahead.

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Biological agents

An alphabet of horrors

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What they are and what they do

Get article background

SCIENTISTS divide the biological agents currently considered as potential weapons into three categories:

Category A. These are the most dangerous and the easiest to spread; they produce high rates of death, are likely to cause panic and disruption, and require special preparation by the public-health system. The diseases caused are **anthrax**, **botulism**, **tularaemia**, **plague**, **smallpox** and **haemorrhagic fever**.

Category B agents produce fewer cases of disease in those exposed and have lower death rates, but are still reasonably easy to disseminate. The diseases they cause include some animal infections that can jump to humans, such as **glanders**, which occurs mainly in horses and donkeys; **brucellosis**, which causes herbivores to abort; and blights that affect crops.

There is a large overlap between preparing for bioterrorism and guarding against natural outbreaks; **foot-and-mouth disease** in 2000 did huge economic and social damage in Britain. A draft report on agricultural bioterrorism by America's National Research Council concludes that a terrorist armed with foot-and-mouth or soyabean rust could easily slip into the country undetected.

Category B also includes biological toxins that directly poison a host. Ricin, derived from castor beans, kills within days if swallowed, injected or inhaled. In 1978 Bulgarian agents killed a dissident émigré by using a specially-equipped umbrella to inject a pellet coated with ricin into his leg. Also in Category B are food and water-borne disease agents such as **salmonella**, **E. coli 157** and **cholera** bacteria.

Category C agents include emerging diseases that could be engineered to make them more suitable for mass dissemination. They are easy to find in some parts of the world, and can cause high rates of disease and death. They include **hantavirus**, **yellow fever** and tick-borne **encephalitis** viruses.

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Smallpox vaccine

Scrambling for safety

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A rare glimpse of preparations outside America

Get article background

THE World Health Organisation knows of around 200m smallpox vaccine doses around the world, not including America's new purchases. Much of the vaccine is old, frozen for several decades. Other types are new, produced mainly by two companies, Acambis in America and Bavarian Nordic, a Danish-German company. These are purer, and should have fewer side-effects. But Stephen Prior, of the Potomac Institute for Policy Studies, says their effectiveness has not been tested on humans.

Like America, most other countries stopped giving babies anti-smallpox jabs in the late 1970s. But activity has revived, especially in countries that are likely terrorist targets. Most governments (especially France's) are keeping policy secret. But here is what is known:

Australia is buying its first 50,000 doses of vaccine—the old type—from Aventis Pasteur, a French company. It plans to buy more next year, enough to contain an outbreak in big cities. Recent spending on anti-bioterrorism measures, including the Aventis purchase, comes to around A$11.4m. Australia's hospitals rehearsed for terrorist attacks before the Sydney Olympics two years ago.

In August, the government of **Israel** said it had enough vaccine for everyone in Israel, including the West Bank and Gaza. Some 15,000 emergency workers have been offered voluntary inoculation; most have turned up. The government is now worried that few of those inoculated have donated blood, which could be used to make antidotes for those who develop bad side-effects to the vaccine.

In **Britain**, the government plans to vaccinate emergency workers and to stockpile a lot of vaccine, though it won't say how much. It already has some old vaccine, and in April it bought £32m-worth of new vaccines from PowderJect, a British company linked with Bavarian Nordic. Britain's hospital readiness, however, is poor. A recent report from the National Audit Office found that one-third of health authorities had not tested mass-casualty plans.

In **Germany**, the federal government has asked the states to buy vaccine for every resident. It set the example by buying 6m doses (enough, when diluted, to vaccinate 24m Germans), with enough for 11m more people arriving in 2003.

In **Japan**, the government already has some vaccine, and hopes to have 10m doses by next year, with more to come. It has already spent some ¥5.7 billion ($47.5m) on bioterror preparations.

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Computer chips

Pile 'em high

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Researchers think three-dimensional chips could be possible

AS THE components on computer chips get smaller and more crowded, their wiring becomes ever more complicated. For years, chip designers have struggled to devise better ways of wiring transistors together, to increase the speed at which they can talk to each other. In some ways the problems of connecting increasing numbers of components are analogous to those of urban sprawl. And a possible solution might also be borrowed from urban planning: build upwards. And at December's International Electron Devices meeting, in San Francisco, Kathryn Guarini from IBM's T.J. Watson Research Centre in Yorktown Heights, New York, and her colleagues will discuss an idea to do just that.

The plan is to stack high-performance circuit layers so intimately that they can be thought of as a single chip built on many circuit layers. This has been tried before, by growing a layer of silicon on top of a standard chip and then using it to create another layer of circuitry. But the high-temperature processes used to make the circuits in the second layer then degrade the performance of those in the first.

According to IBM, such problems may be overcome by making each complete layer of circuitry on a separate wafer, and only then sticking them together at low temperatures. First, a thin piece of glass is stuck to the face of the upper layer of the wafer. The back of this wafer is then ground and etched in a process that stops when a buried layer of silicon oxide is exposed. The result is a transparent wafer that is as thin as 200 millionths of a millimetre. The bottom of this very thin wafer is then aligned, and bonded, with the exposed silicon of the surface of the lower circuit layer. And, as this is done at low temperatures, it avoids the thermal damage to circuitry caused by other 3D-stacking techniques.

Because the upper layer is so thin, connections to circuits can be of the same dimensions as would be found in a chip of only a single layer. Once the glass wafer has been removed from the upper wafer, standard chip-production techniques can create tiny connections between the two circuit layers—a step that IBM has so far not taken. The result is a chip built on two or more layers, whose active area is larger than its “footprint”, but in which the connecting wires can, on average, be shorter. Because the wires are shorter, the chip may be able to run faster. Having a greater available area also gives designers the freedom to create more powerful chips.

There are a number of further possible benefits to such a system. For one thing, it may cut the amount of power that a system uses, because more of the system's signals can be moved around on the same chip, rather than having to be driven at relatively high power across circuit boards between separate chips.

The chip may also solve another problem. Because getting information in and out of a processor takes more time than processing, there is a trade-off between creating very fast chips and keeping them busy. IBM's 3D technique could be used to create a separate circuit layer of “buffers” that would marshall the information flowing to and from a processor, so that designers could create faster processors knowing that they could be kept busy.

Three-dimensional stacking offers other potential advantages. Because it works on whole wafers rather than on individual chips, it could be used to connect different types of circuit layers into one very dense block. At the moment, for example, it is difficult to integrate the complex high-frequency radio circuitry of a mobile phone with the digital computing circuitry that handles the rest of its functions. Using the 3D technique, such circuits could be built on separate optimised processes and then brought together in a stack. The process might even be extended to optical transmitters and receivers, which are built on non-silicon substrates such as gallium arsenide, and can be integrated with silicon circuitry, creating previously unimagined levels of integration. In the world of electronic real estate, the sky really may be

the limit.

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Conservation

Going with the flow?

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Environmentalists are arguing over how to cure Florida Bay's ecological problems. A lot may be at stake

POURING water into the sea sounds harmless enough. But in Florida Bay, a large and shallow section of the Gulf of Mexico that lies between the southern end of the Everglades and the Florida Keys, it is proving highly controversial. That is because researchers are divided over whether it will help or hinder the plants and animals that live in the bay.

What is at risk is the future of the bay's extensive beds of sea grasses. These grow on the bay's muddy floor and act as nurseries for the larvae of shrimps, lobsters and fish—many of them important sport and commercial-fishing species. Also in danger is an impressive range of coral reefs that run the length of the Florida Keys and form the third-largest barrier reef in the world. Since the 1980s, coral cover has dropped by 40%, and a third of the coral species have gone. This has had a damaging effect on the animals that depend on the reef, such as crabs, turtles and nearly 600 species of fish.

What is causing such ecological change is a matter of much debate. And the answer is of no small consequence. This is because the American government is planning to devote $8 billion over the next 30 years to revitalising the Everglades. Seasonal freshwater flows into the Everglades are to be restored in order to improve the region's health. But they will then run off into the bay.

Joseph Zieman, a marine ecologist at the University of Virginia, thinks this is a good idea. He believes that a lack of freshwater in the bay is its main problem. The blame, he says, lies with a century of drainage in the Everglades aimed at turning the marshes into farmland and areas for development. This has caused the flow of freshwater into Florida Bay to dwindle, making the water in the bay, overall, more saline. This, he argues, kills the sea grasses, and as these rot, nutrients are released that feed the microscopic plants and animals that live in the water. This, he says, is why the bay's once crystal-clear waters often resemble a pea soup. And in a vicious circle, these turbid blooms block out sunlight, causing more sea grasses to die and yet more turbidity.

Brian Lapointe, a marine scientist at the Harbour Branch Oceanographic Institution at Fort Pierce in Florida, disagrees. He thinks sea grasses can tolerate much higher levels of salinity than the bay actually displays. Furthermore, he notes that, when freshwater flows through the Everglades were increased experimentally in the 1990s, it led to massive plankton blooms. Freshwater running off from well-fertilised farmlands, he says, caused a fivefold rise in nitrogen levels in the bay. This was like pouring fuel on a fire. The result was mass mortality of sea grasses because of increased turbidity from the plankton. Dr Lapointe adds that, because corals thrive only in waters where nutrient levels are low, restoring freshwater rich in nitrogen will do more damage to the reef.

It is a plausible theory. The water flowing off crops that are grown on the 750,000 acres of heavily fertilised farmland on the northern edge of the Everglades is rich in nitrogen, half of which ends up in the bay. But Bill Kruczynski, of America's Environmental Protection Agency, is convinced that nitrogen from farmlands is not the chief problem. Some coral reefs well away from any nitrogen pollution are dying and, curiously, a few are thriving. Dr Kruczynski thinks that increased nutrients arriving from local sewage discharges from the thousands of cesspits along the Florida Keys are part of the problem.

Such claims and counterclaims make the impact of the restoration plan difficult to predict. If increased salinity is the main problem, the bay's ecology will benefit from the Everglades restoration project. If, however, nitrogen is the problem, increasing the flow of freshwater could make matters much worse.

If this second hypothesis proves correct, the cure is to remove nitrogen from farmland or sewage

discharges, or perhaps both. Neither will be easy. Man-made wetlands, at present being built to reduce phosphate run off into the bay—also from fertilisers—would need an algal culture (a sort of contained algal bloom) added to them to deal with discharges from farmlands. That would be costly. So too would be the replacement of cesspits with proper sewerage—one estimate puts the cost at $650m. Either way, it is clear that when, on December 1st, 3,000 square miles of sea around the reef are designated as a “protective zone” by the deputy secretary of commerce, Sam Bodman, this will do nothing to protect the reef from pollution.

Some argue, though, that there is a more fundamental flaw in the plans for the bay: the very idea of returning it to a utopian ideal before man wrought his damage. Nobody knows what Florida Bay was like before the 1950s, when engineers cut the largest canals in the Everglades and took most of the water away. Dr Kruczynski suspects it was more like an estuary. The bay that many people wish to re-create could have been nothing more than a changing phase in the bay's history.

These arguments do not merely threaten to create ecological problems but economic ones as well. The economy of the Florida Keys depends on tourism—the local tourist industry has an annual turnover of $2.5 billion. People come for fishing-boat trips, for manatee watching, or for scuba diving and snorkelling to view the exotically coloured corals. If the plan to restore the Everglades makes problems in the bay and the reef worse, it could prove a very expensive mistake.

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The universe

Turn out the stars

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Reuters

If you were hoping for a simple universe, the prevailing theory of how it works is repellent, even to scientists who propounded it

WHAT is the fate of the universe? Cosmologists tell us that it all began with a big bang, and has been expanding ever since. But what will happen next? Until recently, it was thought that there were only two possible answers, depending on the net weight of all the galaxies in the universe. If the mass exceeded a certain threshold, then the relentless attractive force of gravity would pull the galaxies back together, ultimately reversing the expansion and causing everything to implode in a catastrophic big crunch. Or, if there was not quite enough mass for gravity to act upon, then expansion would go on forever, but at a slower and slower pace in a never-ending *rallentando*.

In 1998, two competing research groups concluded that both answers are wrong. The expansion of the universe is, apparently, getting faster and faster. This completely unexpected result implied there is a cosmic anti-gravity force, never measured in any laboratory, causing galaxies to repel one another. If true, then the universe will last forever, but will become a profoundly lonely place. As the galaxies recede ever faster, the light their stars emit (and the radio signals their alien civilisations might send) will eventually fail to keep pace with the expansion. Our galactic neighbours will fade from the night sky into oblivion.

The Extravagant Universe: Exploding Stars, Dark Energy and the Accelerating Cosmos
By Robert P. Kirshner

Princeton University Press; 320 pages; $29.95 and £19.95

Buy it at
Amazon.com
Amazon.co.uk

More than one book already exists about this momentous discovery, but this new entry, “The Extravagant Universe”, by Robert Kirshner, is probably the best one to read, despite its weaknesses. There is a lot of unexplained jargon, and the pace is awkward, alternating between the jovial informality of an after-dinner speech and challenging discussions of graphs and mathematical symbols. Donald Goldsmith's “The Runaway Universe” (Perseus, 2000) is on the whole clearer in its explanations. But Mr Kirshner has the great advantage over him and other authors in this field of having taken a leading part himself in the research. This is an insider's account of how the work was done. Besides giving an up-to-the-minute account of the science, Mr Kirshner lets us share vicariously in the thrill of discovery.

The science involves supernovae—vast explosions of stars. One type of supernova, we learn, always explodes with about the same energy, making it possible to deduce the distance to the explosion from its observed brightness. This makes supernovae useful landmarks for charting the size and expansion rate of the universe; at least it would if we could predict when supernovae would occur. In the 1990s, however, astronomers found a way to get round the problem: they devised techniques for surveying thousands of far galaxies at once, enough to be sure of finding at least some supernovae at any one time.

Encouraged by this advance, Mr Kirshner helped organise a team to measure what he thought would be the slowing-down of the cosmic expansion. The story follows the team members as they race to mountain-top observatories in Arizona, Hawaii and Chile, desperately trying to outsmart a competing team of researchers. Mr Kirshner shares with readers his team's astonished e-mail correspondence as it dawns on them that their observations will demand a complete revision of the theory of the universe.

Running just below the main storyline is an undercurrent of philosophy. Scientists have long believed—or hoped—that the basic laws of the universe would be beautiful. They had in mind a simple, austere beauty, with an air of inevitability, like a sunrise or a short mathematical proof. Mario Livio's, “The Accelerating Universe” (John Wiley, 2000), dwells admirably on this topic. Mr Kirshner shows us that an accelerating universe is not beautiful. In the new scheme, so as to provide enough repulsion to match the observed acceleration, 70% of the universe has to be made of a mysterious substance that has been dubbed dark energy. Around 25% is dark matter, a different but equally invisible stuff, hypothesised to explain how galaxies have the proper mass needed to hold them together. Only 5% of the universe is made of ordinary atoms that compose stars, planets and everything on Earth.

That seems unduly complicated and downright ugly. Nor is this all. According to supernova measurements, acceleration began in astronomy's yesterday, only a few billion years ago. Why not at the start or trillions of years hence? Why now? That acceleration is occurring just as it is observable by humans smells of coincidence or contrivance. That is why, when a colleague first suggested that on the data there must be a universal repulsive force, Mr Kirshner felt repelled. “In your heart,” he told him, “you know this is wrong.” But, before long, the evidence swayed him. It seems the actual universe is less simple and less beautiful than the world mathematicians have dreamed of. The extravagant universe Mr Kirshner describes is gaudy too.

The Extravagant Universe: Exploding Stars, Dark Energy and the Accelerating Cosmos.
By Robert P. Kirshner.
Princeton University Press; 320 pages; $29.95 and £19.95

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About sponsorship

Business-crime writing

Corporate delicti

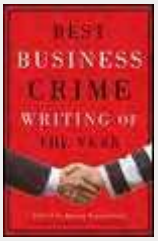
Nov 28th 2002
From The Economist print edition

HERE'S a good idea. A collection of some of the most gripping accounts of America's corporate crimes over the past year. Published appropriately on December 2nd, the first anniversary of Enron's bankruptcy, it could be a Christmas present for that awkward uncle who has stopped wearing ties.

The main characters are all there: WorldCom's Bernie Ebbers crying in the chapel, praying that "my witness for Jesus Christ will not be jeopardised" by his unpaid $400m company loan; Arthur Andersen's David Duncan shredding Enron documents with the SEC in hot pursuit; and Martha Stewart icily tossing near-perfect salads on TV before being quizzed about her alleged insider dealing.

Striking are the modest origins of so many of the actors: Adelphia's John Rigas, son of a Greek immigrant who ran a hot-dog stand, arrested in July and accused of systematically looting the now bankrupt company of billions; Mr Ebbers, former milkman who made his home in backwoods Clinton, Mississippi; and Ms Stewart, New York socialite born Martha Kostyra of poor Polish immigrants in New Jersey, hobnobbing with Sam Waksal, son of Polish Holocaust survivors and founder of a biotech business, ImClone. It used to be said that it took three generations for family fortunes to be made and lost. Now, in little more than a decade, Americans can rise from hot-dog stands to billions of dollars and back again.

Best Business Crime Writing of the Year
Edited by James Surowiecki



Anchor Books; 253 pages; $12

Buy it at
Amazon.com

It is always possible to quibble with the choices in a compendium like this. There is, for instance, nothing from outside America, no view of it all from abroad. Nor is there space for Malcolm Gladwell's marvellous piece in the *New Yorker* examining the McKinsey-inspired folly of the attempt by the Enron boss, Jeffrey Skilling, to bolt an MBA culture on to what was at the time little more than an electric utility. A more serious failing is the fragmented picture the book gives of this recent spate of corporate malpractice. The authors do not each write about a separate case. They are all addressing the same crimes, but from different perspectives. It is as if Ruth Rendell had written the bit where they find the body; P.D. James the autopsy and the scenes in the morgue; and Patricia Cornwell the chase and brutal childhood of the victim. Titillating stuff. But, at the end of the day, there's no answer to the question everybody's asking: who dunnit?

Best Business Crime Writing of the Year.
Edited by James Surowiecki.
Anchor Books; 253 pages; $12

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About sponsorship

Gershom Scholem

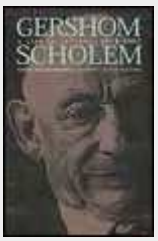
A good sectarian

Nov 28th 2002
From The Economist print edition

“HOW you got it right, a thousand times over!” wrote Betty Scholem in November 1938 from Berlin to her son, Gershom, who had emigrated to Palestine 15 years earlier. By this time one brother, Werner, a former Communist politician, had been thrown into a Nazi prison; he eventually died in Buchenwald. Hitler's anti-Jewish policies had strangled the economic life out of the once-prosperous Scholem family. Gershom, meanwhile, had become both pioneer and professor, transplanting Germany's academic culture to British-ruled Palestine.

To be right when the world from which one sprang has gone so wrong is to risk a certain other-worldliness. Scholem's esoteric work, the rescue of the kabbalah—Jewish mysticism—from scholarly neglect, seems to guarantee it. He saved libraries of Jewish books in Europe after the second world war but could do little for his friends and family during it. What can this lucky bookworm say to readers who are not especially curious about the kabbalah or about the history of universities in Israel?

Gershom Scholem: A Life in Letters, 1914-1982
By Edited and translated by Anthony David Skinner



Harvard University Press; 547 pages; $35 and £23.50

Buy it at
Amazon.com
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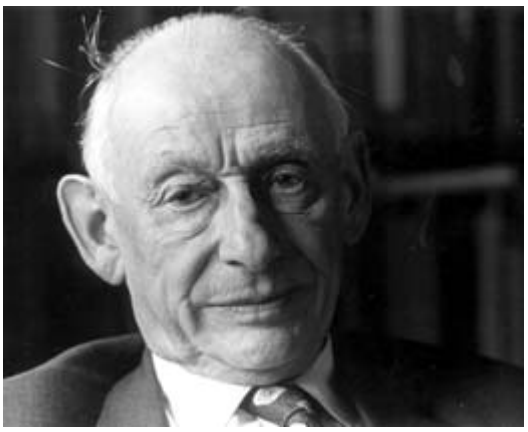
A great deal, as this selection of letters to and from Scholem makes clear. Some of its pleasures are simple ones: the spellbinding story of the Scholem clan, which is an almost Micheneresque saga of the 20th century, and a cast of celebrity intellectuals. But this narrative also asks difficult questions: one is whether cleaving to a particular people and its tradition constitutes a self-imposed exile from a realm of more-universal concerns. A second, raised only by implication, is whether Israel's present troubles spring from this choice.

Harvard University Press



Scholem plunged deep

Three of the four Scholem boys fought for the kaiser in the first world war (Gershom escaped by feigning madness). The two eldest then enlisted in the world of their father, a Jewish printer who thought himself fully integrated into German life. The younger pair rebelled: Werner embraced the universalism of left-wing politics. Gershom chose Zionism, casting his lot with the Jewish sliver of mankind.

Clever as this choice seemed to his mother, doubt runs through these letters. Scholem's correspondence with such luminaries as Theodor Adorno, Hannah Arendt and Walter Benjamin shows him fully engaged with western intellectual life. Yet he was often at odds with them over his love of the Jewish particular and their incomprehension of it. Scholem tried and failed to persuade Benjamin, one of his best friends, to make Hebrew the medium and object of his inquiries into culture and language, a failure he called “our private apocalypse”. He broke with Arendt over her study of Adolf Eichmann, executed by Israel in 1962 for his part in the butchery of Europe's Jews. Scholem recoiled from Arendt's apparent suggestion that Jews were complicit in their own destruction, accusing her of lacking *ahavath Israel* (love for the Jewish people). Arendt replied, “I love only my friends and am quite incapable of any other sort of love.”

On loving friends, not peoples, many readers will agree with her. Scholem, a religious but unorthodox Jew, defended tradition in terms that sound not merely unfashionable but even sinister, especially to

post-September 11th ears. “I am a ‘sectarian',” he told Arendt. And, for many, Israel's current travails will look like the natural outcome of a misguided sectarian project: the founding of a Jewish state.

The letters do not offer a full defence of Scholem's sectarianism. He was a passionate but politically flexible Zionist, at one time favouring a bi-national state for Jews and Arabs. He called himself an anarchist. Scholem would have said that attachment to a particular tradition broadens understanding, and his scholarship bears this out. His investigations of the kabbalah illuminated non-Jewish religions and were illuminated by them. Arendt walked on ground that Scholem excavated.

The editor of this collection, Anthony Skinner, does too little to explain this. His translations, thankfully, let the correspondents speak in voices that sound like their own. But his commentary, which aims to make the concerns of a bygone generation of intellectuals accessible to today's readers, ends up subtly belittling them. He calls the enthusiasms of the younger Scholem boys for revolution and utopia “utterly foreign” to today's readers and advises them to set aside their “specific content”. This is wrongheaded, and not because, as Mr Skinner suggests, Scholem's scholarship contains private thoughts in code. Scholem brought to the mystical strain in Jewish tradition both unquestioning love and the critical poise of a demanding mind. In these twin scholarly passions, Scholem showed indeed how right he was.

Gershom Scholem: A Life in Letters, 1914-1982.
Edited and translated by Anthony David Skinner.
Harvard University Press; 547 pages; $35 and £23.50

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New fiction

Life's a beach

Nov 28th 2002
From The Economist print edition

THE eight stories in Anthony Doerr's excellent debut collection have one thing in common. They all make strange things seem ordinary and ordinary things strange. In the title story, for instance, a blind Canadian shell collector abandons his wife and child to live alone on a remote island. Among other things, it is a story about illness, death and family breakdown.

Yet these weighty matters are dealt with coolly and briskly. It is only in the long, richly sensuous descriptions of shells and sand and water that any sense of the story's strong emotional undertow is felt. As a boy, already blind, the main character's life is changed when, wading in the sea, he touches a shell beneath his feet. “He felt the sleek egg of its body, the toothy gap of its aperture. It was the most elegant thing he'd ever held.”

This kind of displacement of personal feeling into physical detail is still more pronounced in “The Caretaker”, in which a Liberian refugee called Joseph makes his way to safety. The unspeakable horrors of civil war are evoked in matter-of-fact lists. It is only later, in America, that Joseph begins to exorcise these demons, partly through his cultivation of a small, and painstakingly described, vegetable garden.

Loss, estrangement and distance—and a mood finely poised between melancholy and melodrama—are the collection's keynotes. But Mr Doerr frames and executes these stories with seemingly effortless panache, and there is always something reassuring in their artistry to offset their bleakness.

The Shell Collector.
By Anthony Doerr.
Scribner; 218 pages; $23.
Flamingo; £14.99

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By Anthony Doerr

Scribner; 218 pages; $23.
Flamingo; £14.99

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About sponsorship

New fiction

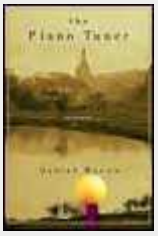
Carry on up-river

Nov 28th 2002
From The Economist print edition

DANIEL MASON, a young American medical student, has worked on the Thai-Myanmar border. This, his first novel, was largely written there. You can tell. It is a song to that region, to the colours and light, to the graceful people, to their stories, music and dance, to their bazaars, their pagodas and birds. Ostensibly, he has written a historical novel about the British in colonial Burma in the 1880s; but it's all flummery beside his infectious enchantment with these things.

Not that there's any lack of history. Mr Mason provides great slabs of it—on the Anglo-Burmese wars, on the ethnogeography of the region, on British-French rivalry. But in spite of pith helmets, tiger hunts and club gossip, the period eludes him. His dialogue keeps swerving, like a compass needle, into the late 20th century ("Please, feel free"), and the consistently post-colonial, issue-alert consciousness of the chief character places the book squarely in modern, liberal America.

The Piano Tuner
By Daniel Mason



Knopf; 312 pages; $24.
Picador; £16.99

Buy it at
Amazon.com
Amazon.co.uk

The back story involves the hauling of an Erard grand piano up river to the remote jungle fort of a legendary official, a nice Mr Kurtz who reads Tennyson and translates Homer, and who has subversive ideas about the pacifying powers of music. Hence the piano tuner, Edgar Drake, who is summoned from his middle-aged, married, London existence to make the mad journey into the Burmese interior, only to find himself without an exit—helplessly in thrall to the spell of the east.

The novel is cunningly filmic. And why not? After "The Piano", "The Piano Teacher" and "The Pianist", all that's missing is a piano tuner. The medical scenes—an amputation, a malarial fever—are particularly gripping. And it all looks beautiful. Grand pianos are photogenic, especially on a raft, or in a sling, with a porter's corpse spread-eagled on the lid. But this is not, if you were tempted, a comment on the deadly hand of cultural imperialism. It's an eyeful and an earful. Drake, in a dream of musical meditation, plays Bach to a sequinned chieftain. Quite what the chieftain thought, we never discover. The reader is lulled, like Tennyson's lotus eaters, and forgets to ask.

The Piano Tuner.
By Daniel Mason.
Knopf; 312 pages; $24.
Picador; £16.99

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About sponsorship

Jazz CDs

The roots of rock

Nov 28th 2002
From The Economist print edition

Jazz recordings for holiday gifts

TO MANY jazz fans, the overwhelming popularity of rock simply confirms Gresham's law: bad music drives out good. Yet one of the most enjoyable reissues of the year traces jazz and rock to their common, vibrant root.

Drawn from the extensive vaults of RCA Victor, “When the Sun Goes Down: A Secret History of Rock 'n' Roll” is a four-CD survey of the blues from the 1920s to the 1950s. The first disc, “Walk Right In” offers earthy authenticity from Texas to Tennessee both by legendary figures (Leadbelly, Bukka White) and the unfairly forgotten (Milton Brown and his Musical Brownies). In Volume 2, “The First Time I Met the Blues”, Louis Armstrong accompanies country singer Jimmie Rodgers, while the Memphis Jug Band huffs and puffs with homespun panache.

Volume 3 celebrates a vital melting pot: “That's Chicago's South Side” ranges from classic boogie-woogie by Meade Lux Lewis to insinuating vocals by Jazz Gillum and Tampa Red. Finally Volume 4, “That's All Right” arrives at the dawn of rock 'n' roll, with the likes of Arthur “Big Boy” Crudup, idolised and imitated by Elvis Presley.

Certain jazz musicians have always courted the unbuttoned energy of rhythm and blues. A four-CD set from Proper Records, “The Lionel Hampton Story”, rousingly salutes the early career of Hampton, a pioneering master of the vibraphone, drummer, two-finger pianist and leader of one of the most exuberant of all big bands. Beginning with a selection of the effervescent all-star combo records he made in the 1930s, it moves on to such big band classics as his driving theme, “Flying Home” and “Hamp's Boogie-Woogie”. And just when the band's storming beat seems a touch unrelenting, there are meltingly beautiful ballads, above all his astonishing, 15-minute “Stardust”.

Hampton died only this year, aged 94, but one of his most talented colleagues barely reached a quarter-century. Charlie Christian has long been regarded as the founding father of the electric guitar and key innovator in the new musical language of be-bop. By the time of Christian's death in 1942, his brief but epoch-making career had justified the title of the handsome commemorative box issued by Columbia Legacy: “The Genius of the Electric Guitar”. Wittily packaged to resemble a guitar amplifier, its four discs contain all the recordings Christian made as a revelatory soloist with Benny Goodman, plus alternate takes, rehearsals and spur-of-the-moment jam sessions. It is a treasure trove not only for lovers of the guitar, but of the finest small group jazz, spearheaded by Christian's vibrant tone, nimble lines and adventurous harmonies.

A different sort of tribute by some contemporary masters delighted jazz lovers this year, first in a concert tour and then on CD. “Directions in Music” brought together the formidable talents of pianist Herbie Hancock, saxophonist Michael Brecker and trumpeter Roy Hargrove, all of them one-time associates or deep admirers of two legends of modern jazz, Miles Davis and John Coltrane. Their CD, recorded live, celebrates the achievements of Davis and Coltrane in a subtle, imaginative programme by a finely-honed quintet making the best kind of homage.

Atmospherics

A CD by a Swedish trio also demonstrates intuitive teamwork, as well as proving how international top-flight jazz has become. Though the threesome bears the name of their pianist, Esbjorn Svensson, who also composes most of their material, he refers to them collectively as EST, and their CD “Strange Place for Snow” is very much a co-operative enterprise. And local conditions apply. Whereas historically

American jazz has been based on tunes, swing and individual solos, EST create distinctly Scandinavian and atmospheric mini-tone poems, with modal harmonies and rock-style rhythmic motifs.

The effect can be mesmerising, as on “Behind the Yashmak”, conjuring the intense inner world of a Muslim woman. Mr Svensson has said that his trio is less concerned with playing jazz than with realising their own sound, a statement which might worry some jazz devotees.

Certainly, hard-core fans were vexed last year when an acclaimed Canadian singer-pianist, Diana Krall, seemed to be going commercial with a swooning album accompanied by strings. But her latest CD returns to her roots. Recorded live at Paris Olympia, “Live in Paris” features some orchestral backing but mainly showcases Miss Krall having her swinging way with such unbeatable standards as “Fly Me to the Moon”—just the thing to set toes happily tapping at holiday time.

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About sponsorship

Cho Choong Hoon

Nov 28th 2002
From The Economist print edition

Cho Choong Hoon, a maker of South Korea, died on November 17th, aged 82

Reuters

AT THE start of his business career in 1945, Cho Choong Hoon owned one lorry. By the 1990s his South Korean firm, the Hanjin group of 21 companies, had assets worth about $20 billion. Mr Cho was one of the extraordinary people who helped to transform South Korea from a poor Asian country into one with an economy comparable to that of, say, the Netherlands. These days, speak to South Koreans whose recent forebears were peasants, and most will say they now regard themselves as middle class.

Mr Cho was often asked how he did it. “Timely decisions and painstaking effort”, he said. There was a lot of truth in this reply, however hackneyed. Opportunism and hard work enabled Mr Cho to turn a profit as South Korea endured many years of war and military dictatorship. When North Korea invaded in 1950 Mr Cho's business expanded rapidly as his lorries carried ammunition and other supplies for the American-led United Nations' forces defending the South. By the time of the start of the Vietnam war in 1954, Mr Cho had expanded into shipping and he secured contracts to move supplies from America's Korean bases to the South Vietnamese government. Among other shipping innovations, he introduced containerisation to Korea.

In 1961 General Park Chung Hee took power in a military coup and inaugurated what came to be called the South Korean “miracle”, with growth of around 9% in real terms year after year. Park had served in the Japanese armed forces, and believed that South Korea could prosper, as Japan was doing, by creating the conditions under which strongly-led companies could expand. Companies that won the trust of Park could take out large foreign loans guaranteed by the government, and were assured of a cheap and docile workforce forbidden to bargain or strike. The government's vast security network would deal with any dissent.

One company leader Park trusted was Mr Cho. In 1969 he gave him the job of privatising the loss-making state airline. Under Mr Cho, Korean Air became highly profitable, and the world's second-largest cargo carrier. Its success was perhaps the high point of his career. Transport, said a happy Mr Cho, served the economy like the heartbeat served the human body.

A test of friendship

For the United States Park was an embarrassing friend. He was among the most loyal of Asian leaders. When America became increasingly involved in the Vietnam war in the 1960s Park allowed it to hire 300,000 South Korean soldiers to fight as mercenaries. South Korea's thriving industry, bounding along under such captains as Mr Cho, was much admired by Americans more used to demands for aid. But Park's South Korea practised torture and murder. In 1973, Kim Dae-jung, a critic of the regime who later became president, was kidnapped by Park's security agents who planned to take him out to sea to drown him. Only a desperate plea from the Americans saved his life.

The American attitude to such regimes as South Korea's was perhaps best summarised by Jeane Kirkpatrick, who held government office under Ronald Reagan. In an essay on foreign policy, “Dictatorships and Double Standards”, in *Commentary* magazine she wrote that it was dangerous at the time of the cold war to destabilise “generally friendly regimes”, which would gradually become more democratic. Other American officials felt more comfortable when focusing on what seemed to be the non-controversial aspects of Mr Cho's growing empire, such as education. He made generous contributions to

a number of South Korean colleges, and set up a special college for Hanjin employees to study to university standard. As the economy grew, having a well-educated workforce helped to keep the country at least in pace with its Asian competitors.

By November 1979, when the Kirkpatrick essay was published, Park had gone, murdered the previous month by his security chief. When South Korea did eventually evolve towards democracy, Mr Cho's business empire was under a cloud. Aircraft of Korean Air had been involved in a series of accidents in which more than 700 people died. A waspish broker advised his clients, “Buy but don't fly.” When Kim Dae-jung was elected president in 1997 he said family-run *chaebol* (conglomerates) such as Mr Cho's concentrated too much on profits. They should, he said, be put in the hands of professionals.

A chastened Mr Cho resigned as president of Korean Air, but retained the chairmanship of the Hanjin group as a whole. Worse was to follow. Korean Air was accused of evading taxes amounting to $53m. But merciful prosecutors, while chasing the missing taxes, declined to prosecute Mr Cho, because of his age and his contribution to the country's economic growth. South Koreans mostly approved, and over the past week have been paying a respectful goodbye to almost the last representative of the generation that, by hook or by crook, got the country through a testing period. Seoul newspapers have been generous with their praise for “the godfather” of the transport industry. Perhaps not the most felicitous of expressions, but no doubt well intentioned.

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Overview

Nov 28th 2002
From The Economist print edition

America's economy grew in the third quarter at a revised 4.0% annual rate, up from the earlier estimate of 3.1%. The revised figure shows a big jump over the 1.3% annual rate of growth in the second quarter. Car sales gave a big boost to America's economy, but much of that was owing to zero-interest-rate financing and other incentives, which are now reaching their limit. Overall, consumer spending accounted for the lion's share of third-quarter growth.

Recent consumer-confidence figures give reason to hope this will continue. The Conference Board's index of consumer confidence rebounded from a nine-year low of 79.6 in October to 84.1 in November. Business spending in the third quarter was weaker than originally estimated, however; and most forecasters reckon that a rebound in corporate spending is required for any sustained recovery. America's booming housing market slowed slightly in October, as new-home sales slid by 4.5%.

Europe's hopes for a strong recovery have been weakened by low growth figures in some of its largest economies. In **France**, until recently a brightish spot in the dim **euro area**, GDP grew by only 0.9% at an annual rate in the third quarter—even less than the typically weaker economies of **Germany** and **Italy**—despite consumers' continued eagerness to spend. The French government raised its estimate of its 2003 budget deficit from 2.6% to 2.8%, edging ever closer to the Maastricht treaty's 3.0% limit.

There was more gloom in **Germany**, where the Ifo index of western German business confidence fell for the sixth month in a row. Companies' appraisal of the present situation improved, but their expectations for the future deteriorated. German consumer prices fell by 0.4% in November; the annual inflation rate fell to 1.1%.

There was better news from **Spain**, where GDP rose by 3.2% at an annual rate in the third quarter, up from a revised 1.8% in the second. Producer prices rose by 1.6% in the year to October.

In **Britain**, annualised third-quarter GDP growth was revised up from 2.7% to 3.4%, the best performance since 2000.

Consumer prices in **Canada** shot up by 3.2% in the year to October, compared with the 2.3% increase in the year to September. Energy prices were the main culprit.

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Output, demand and jobs

Nov 28th 2002
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 2.4	+ 3.8 Q2	+ 3.7	+ 3.5	+ 2.7 Q2	+ 5.4 Q3	6.0 Oct	7.0
Austria	+ 2.5	+ 0.9 Q2	+ 0.7	+ 1.7	− 1.4 Aug	+ 0.4 Aug	4.2 Sep	3.7
Belgium	+ 1.2	+ 0.8 Q3	+ 0.6	+ 1.8	+ 1.3 Sep	− 0.9 Aug	11.9 Oct†	11.5
Britain	+ 3.4	+ 1.8 Q3	+ 1.6	+ 2.6	− 2.5 Sep	+ 6.0 Oct	5.3 Sep††	5.1
Canada	+ 4.3	+ 3.2 Q2	+ 3.4	+ 3.2	+ 3.1 Aug	+ 5.2 Aug	7.6 Oct	7.4
Denmark	+ 4.4	+ 2.0 Q2	+ 1.8	+ 2.1	nil Sep	+ 3.4 Aug	5.3 Sep	5.1
France	+ 0.9	+ 0.8 Q3	+ 1.1	+ 1.8	− 1.1 Sep	− 1.5 Sep	9.0 Sep	8.7
Germany	+ 1.1	+ 0.4 Q3	+ 0.4	+ 1.3	− 1.3 Sep	− 1.3 Sep	9.9 Oct§	9.5
Italy	+ 1.1	+ 0.5 Q3	+ 0.4	+ 1.6	+ 1.2 Sep	− 2.7 Sep	9.0 Jul	9.5
Japan	+ 3.0	+ 1.5 Q3	− 0.7	+ 1.0	+ 5.2 Sep	− 1.9 Sep	5.4 Sep	5.3
Netherlands	+ 0.3	+ 0.1 Q3	+ 0.4	+ 1.4	− 2.3 Sep	+ 0.9 Sep	2.4 Oct**	2.0
Spain	+ 3.2	+ 1.8 Q3	+ 1.9	+ 2.4	+ 3.1 Sep	na	11.2 Sep	10.6
Sweden	+ 2.4	+ 2.1 Q2	+ 1.7	+ 2.4	+ 1.1 Sep	+ 7.4 Sep	3.7 Oct†	4.0
Switzerland	+ 1.3	+ 0.6 Q3	+ 0.1	+ 1.3	− 2.0 Q2	− 1.1 Sep	3.0 Oct†	1.9
United States	+ 4.0	+ 3.2 Q3	+ 2.4	+ 2.7	+ 1.2 Oct	+ 7.6 Sep	5.7 Oct†	5.4
Euro area	+ 1.6	+ 0.7 Q2	+ 0.7	+ 1.7	− 0.6 Sep	+ 1.5 Aug	8.3 Sep	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 8.8	+ 2.5 Q2	na	na	+ 0.8 Sep	+ 3.4 Aug	8.5 Oct†	8.3
Greece	na	+ 4.0 Q2	na	na	− 1.4 Sep	na	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.2 Sep†	1.0
Ireland	na	+ 6.5 Q2	na	na	+ 8.2 Sep	+ 5.2 Sep	4.3 Oct	3.9
Luxembourg	na	+ 3.52001	na	na	− 1.9 Aug	− 0.9 Jun	3.0 Sep†	2.5
New Zealand	+ 7.1	+ 4.0 Q2	na	na	+ 4.3 Q2	+ 8.1 Q3	5.4 Q3	5.2
Norway	+ 3.1	+ 1.7 Q2	na	na	−10.1 Sep	+ 2.8 Oct	3.8 Q3	3.6
Portugal	+ 2.8	+ 0.9 Q2	na	na	+ 0.1 Sep	+ 1.9 Sep	5.1 Q3†	4.0

*% change at an annual rate. †Not seasonally adjusted. ††July-Sep; claimant count rate 3.1% in Oct. §EU harmonised rate 8.3% in Oct. **Aug-Oct.

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Prices and wages

Nov 28th 2002
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.2	Q3	+ 2.5	+ 2.8	+ 2.5	– 0.2	Q3	+ 2.4	+ 3.6	Q3	+ 4.0
Austria	+ 1.8	Oct	+ 2.5	+ 1.8	+ 1.7	+ 0.3	Oct	– 0.5	+ 2.3	Sep	+ 2.9
Belgium	+ 1.3	Oct	+ 2.4	+ 1.7	+ 1.4	+ 1.5	Oct	– 4.2	+ 2.1	Q3	+ 3.7
Britain	+ 2.1	Oct	+ 1.6	+ 1.9	+ 2.4	+ 0.6	Oct	– 0.6	+ 3.8	Sep	+ 4.3
Canada	+ 3.2	Oct	+ 1.9	+ 2.2	+ 2.5	+ 0.5	Sep	+ 1.0	+ 2.8	Aug	+ 1.4
Denmark	+ 2.5	Oct	+ 2.2	+ 2.3	+ 2.1	+ 0.8	Oct	– 0.3	+ 3.7	Q2	+ 4.7
France	+ 1.9	Oct	+ 1.8	+ 1.9	+ 1.4	+ 0.3	Sep	– 0.2	+ 3.8	Q2	+ 4.2
Germany	+ 1.1	Nov	+ 1.7	+ 1.4	+ 1.2	+ 0.9	Oct	– 1.1	+ 2.4	Sep	+ 2.3
Italy	+ 2.5	Nov	+ 2.8	+ 2.4	+ 1.9	+ 0.5	Sep	+ 0.4	+ 2.5	Sep	+ 2.4
Japan	– 0.7	Sep	– 0.8	– 0.9	– 0.6	+ 0.3	Oct	– 0.6	+ 1.7	Sep	– 0.5
Netherlands	+ 3.4	Oct	+ 4.3	+ 3.7	+ 2.5	+ 0.6	Sep	+ 0.7	+ 3.4	Sep	+ 4.7
Spain	+ 1.0	Oct	+ 3.0	+ 3.4	+ 2.6	+ 1.6	Oct	– 0.4	+ 4.0	Q2	+ 2.9
Sweden	+ 2.5	Oct	+ 2.7	+ 2.3	+ 2.1	– 1.0	Oct	+ 0.5	+ 2.7	Aug	+ 3.6
Switzerland	+ 1.3	Oct	+ 0.6	+ 0.7	+ 0.9	– 0.6	Oct	– 1.4	+ 2.5	2001	+ 1.3
United States	+ 2.0	Oct	+ 2.1	+ 1.6	+ 2.2	+ 0.6	Oct	– 0.3	+ 3.0	Oct	+ 3.8
Euro area	+ 2.3	Oct	+ 2.3	+ 2.2	+ 1.7	+ 0.1	Sep	+ 0.7	+ 3.3	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.5	Oct	+ 2.2	na	na	+ 0.8	Oct	– 3.4	+ 3.8	Q2	+ 4.9
Greece	+ 3.7	Oct	+ 2.8	na	na	+ 1.9	Sep	+ 1.3	na		na
Iceland	+ 2.4	Nov	+ 8.1	na	na	+ 5.8	Nov	+ 6.8	+ 5.9	Oct	+ 9.1
Ireland	+ 4.7	Oct	+ 4.3	na	na	– 0.4	Oct	– 1.4	+ 4.3	Q2	+ 8.5
Luxembourg	+ 2.2	Oct	+ 2.3	na	na	– 0.3	Aug	– 0.4	– 1.8	Aug	+ 3.4
New Zealand	+ 2.6	Q3	+ 2.4	na	na	+ 1.5	Q2	+ 8.1	+ 2.3	Q3	+ 2.0
Norway	+ 1.8	Oct	+ 2.2	na	na	+ 4.4	Oct	–19.1	+ 4.9	Q2	+ 4.4
Portugal	+ 4.0	Oct	+ 4.1	na	na	+ 0.1	Sep*	na	– 2.6	Jul	– 1.2

*Revised series.

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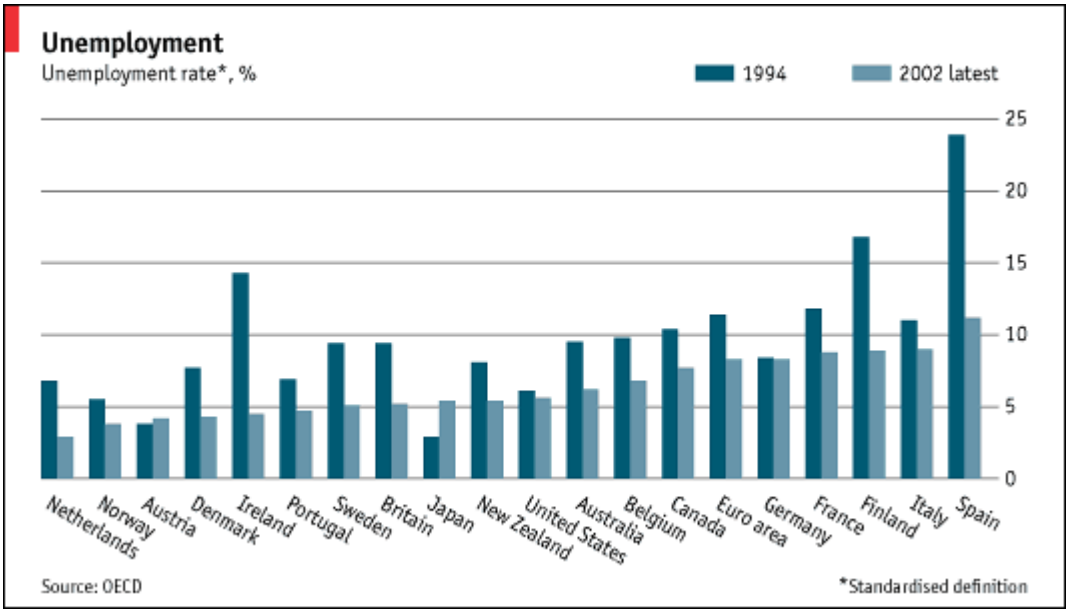
Unemployment

Nov 28th 2002
From The Economist print edition



Joblessness rates in most OECD countries have fallen sharply since 1994. The European Union has seen the biggest improvement; in Ireland and Spain, unemployment has fallen by around ten percentage points. Joblessness in Japan, however, has increased over the past eight years. The OECD expects unemployment rates in most rich countries to fall further after 2004, when labour-force growth is forecast to subside.

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Money and interest rates

Nov 28th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 27th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 6.1	+11.4	Sep	4.84	4.31	4.71	5.52	5.67	6.61
Britain	+ 8.2	+ 5.4	Oct	3.94	3.91	3.97	4.67	4.68	6.00
Canada	+11.1	+ 6.1	Oct	2.73	2.08	3.43	5.19	5.35	6.91
Denmark	+ 4.1	+ 6.4	Oct	3.34	3.75	3.43	4.64	4.78	6.74
Japan	+29.0	+ 3.3	Oct	0.02	0.02	0.05	0.96	1.34	1.04
Sweden	+ 2.6	+ 6.7	Aug	3.79	3.74	4.04	5.01	5.04	4.70
Switzerland	+11.5	+ 5.4	Oct	0.75	2.10	0.97	2.53	3.15	3.60
United States	+ 3.5	+ 6.0	Oct	1.32	2.05	2.06	4.24	4.95	6.37
Euro area†	+ 8.2	+ 7.4	Sep	3.05	3.38	3.04	4.48	4.59	5.19

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 5.11%, Japan No.244 0.985%. Central bank rates: US fed funds 1.25%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 28th 2002
From The Economist print edition

1995=100

	Nov 19th	Nov 26th*	% change on one month	% change on one year
Dollar index				
All items	76.0	76.1	+ 0.8	+15.3
Food	80.0	79.5	– 0.8	+17.1
Industrials				
All	70.6	71.4	+ 3.2	+12.8
Nfa†	72.3	73.3	+ 3.3	+27.4
Metals	69.2	69.8	+ 3.1	+ 2.4
Sterling index				
All items	75.4	76.9	+ 0.7	+ 4.5
Euro index				
All items	98.8	100.8	nil	+ 2.4
Yen index				
All items	98.3	98.6	+ 0.2	+13.3
Gold				
$ per oz	320.05	318.40	+ 0.4	+16.4
West Texas Intermediate				
$ per barrel	26.40	26.41	– 1.2	+37.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 28th 2002
From The Economist print edition

Market indices

	Nov 27th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,968.2	3,440.0	2,855.5	nil	-13.7	-11.7	- 4.1
Austria (ATX)	1,103.9	1,357.2	1,003.7	+ 0.1	-36.5	- 3.2	+ 7.6
Belgium (Bel 20)	2,096.8	2,899.8	1,773.7	+ 1.6	-43.1	-24.6	-16.2
Britain (FTSE 100)	4,144.2	5,323.8	3,671.1	+ 1.2	-40.2	-20.6	-15.7
Canada (Toronto Composite)	6,604.3	7,958.1	5,695.3	+ 1.7	-42.0	-14.1	-13.0
Denmark (KBX)	169.6	233.4	156.4	+ 1.7	-43.8	-24.6	-16.0
France (SBF 250)	2,217.0	3,081.9	1,794.5	+ 5.1	-49.5	-25.6	-17.3
(CAC 40)	3,313.8	4,688.0	2,656.5	+ 5.1	-52.1	-28.3	-20.4
Germany (Xetra DAX)	3,346.1	5,462.6	2,597.9	+ 4.1	-58.5	-35.2	-27.9
Italy (BCI)	1,169.6	1,513.0	974.4	+ 4.1	-46.4	-18.4	- 9.3
Japan (Nikkei 225)	8,875.9	11,979.9	8,303.4	+ 4.9	-77.2	-15.8	- 9.4
(Topix)	869.3	1,139.4	817.1	+ 4.6	-69.9	-15.8	- 9.4
Netherlands (AEX)	357.4	531.2	291.4	+ 5.3	-49.1	-29.5	-21.6
Spain (Madrid SE)	693.5	848.1	568.5	+ 5.9	-39.5	-15.9	- 6.5
Sweden (Affarsvarlden Gen)	165.9	236.8	122.7	+ 5.6	-58.6	-28.3	-17.8
Switzerland (Swiss Market)	5,181.9	6,694.1	4,435.0	+ 2.9	-38.4	-19.3	-10.0
United States (DJIA)	8,931.7	10,635.3	7,286.8	+ 3.6	-23.8	-10.9	-10.9
(S&P 500)	938.9	1,172.5	776.8	+ 2.7	-38.5	-18.2	-18.2
(NASDAQ Comp)	1,487.9	2,059.4	1,114.1	+ 4.8	-70.5	-23.7	-23.7
Europe (FTSE Eurotop 300)*	936.6	1,279.7	797.2	+ 3.0	-45.1	-25.7	-17.4
Euro area (FTSE Ebloc 100)*	795.9	1,125.1	639.4	+ 4.7	-48.7	-28.4	-20.4
World (MSCI)†	830.5	1,024.4	703.7	+ 2.5	-42.7	na	-17.2
World bond market (Salomon)‡	498.9	510.0	430.3	- 0.9	- 2.2	na	+13.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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About sponsorship

Trade, exchange rates and budgets

Nov 28th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2002	Current account The Economist poll % of GDP, forecast 2003	Exchange rate trade-weighted† 1990=100 Nov 27th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Nov 27th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2002‡
Australia	– 2.7 Sep	– 11.6 Q2	– 3.7	– 3.7	74.2	73.1	1.80	1.92	2.78	1.78	1.48	0.1
Austria	– 0.8 Aug	– 1.1 Sep	– 1.8	– 1.8	100.8§	100.3	1.01	1.13	1.56	–	0.83	-1.6
Belgium	+ 17.1 Sep	+ 12.4 Jun	+ 4.9	+ 5.0	100.0§	99.2	1.01	1.13	1.56	–	0.83	nil
Britain	– 46.1 Sep	– 25.8 Q2	– 1.9	– 1.9	105.0	105.5	0.65	0.70	–	0.64	0.53	-1.4
Canada	+ 34.7 Sep	+ 12.1 Q2	+ 2.0	+ 2.1	75.4	75.9	1.58	1.59	2.43	1.56	1.29	0.6
Denmark	+ 7.1 Sep	+ 3.6 Sep	+ 2.2	+ 2.0	103.1	102.3	7.50	8.40	11.6	7.43	6.16	2.2
France	+ 9.8 Sep	+ 26.8 Sep	+ 1.8	+ 1.8	102.9§	101.9	1.01	1.13	1.56	–	0.83	-2.7
Germany	+110.9 Sep	+ 37.6 Sep	+ 1.4	+ 1.0	99.9§	98.7	1.01	1.13	1.56	–	0.83	-3.7
Italy	+ 11.6 Sep	– 1.0 Sep	nil	nil	73.4§	72.7	1.01	1.13	1.56	–	0.83	-2.3
Japan	+ 86.5 Sep	+113.1 Sep	+ 2.8	+ 2.8	132.6	137.4	122	123	188	121	–	-7.9
Netherlands	+ 27.2 Sep	+ 9.0 Q3	+ 3.3	+ 3.6	99.1§	98.1	1.01	1.13	1.56	–	0.83	-0.8
Spain	– 36.4 Aug	– 14.2 Aug	– 1.9	– 1.7	75.0§	74.3	1.01	1.13	1.56	–	0.83	nil
Sweden	+ 14.2 Oct	+ 8.0 Sep	+ 3.3	+ 3.3	78.4	73.9	9.15	10.6	14.1	9.06	7.51	1.7
Switzerland	+ 4.4 Oct	+ 22.7 Q2	+10.0	+10.3	113.9	112.9	1.49	1.65	2.30	1.47	1.22	na
United States	–452.7 Sep	–428.8 Q2	– 4.7	– 4.9	114.0	120.2	–	–	1.54	0.99	0.82	-3.1
Euro area	+ 95.6 Sep	+ 38.0 Sep	+ 0.5	+ 0.6	82.4	78.3	1.01	1.13	1.56	–	0.83	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.1 Sep	+ 9.5 Sep	na	na	79.0§	78.9	1.01	1.13	1.56	–	0.83	3.2
Greece	– 20.3 Sep	– 7.7 Aug	na	na	58.0§	57.6	1.01	1.13	1.56	–	0.83	-1.1
Iceland	+ 0.2 Sep	– 0.1 Q2	na	na	93.0**	87.8	86.4	109.8	133	85.5	70.9	0.3
Ireland	+ 34.2 Aug	+ 0.4 Q2	na	na	89.1§	87.7	1.01	1.13	1.56	–	0.83	-0.5
Luxembourg	– 2.6 Aug	+ 2.1 Q2	na	na	100.0§	99.2	1.01	1.13	1.56	–	0.83	1.8
New Zealand	– 0.4 Oct	– 1.3 Q2	na	na	89.8	79.1	2.03	2.42	3.14	2.01	1.67	1.6
Norway	+ 24.5 Oct	+ 25.6 Aug	na	na	106.8	96.6	7.36	8.97	11.4	7.28	6.04	12.4
Portugal	– 12.8 Jul	– 9.8 Sep	na	na	91.2**	89.5	1.01	1.13	1.56	–	0.83	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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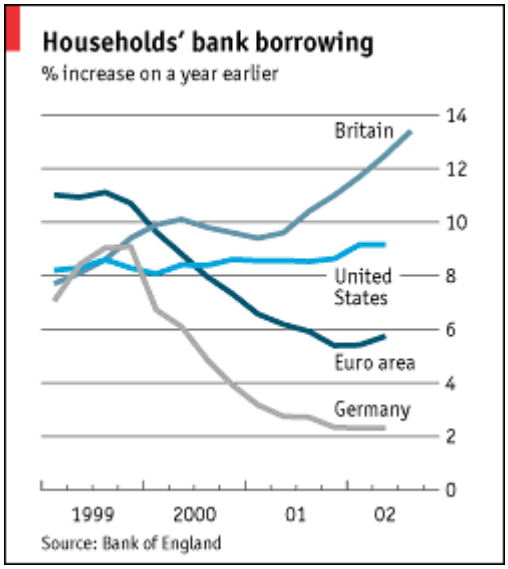
Households' bank borrowing

Nov 28th 2002
From The Economist print edition

Consumers in America and Britain have been taking on more debt in recent years. Thanks partly to falling property values, German households have, however, slowed their borrowing since 1999.



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Overview

Nov 28th 2002
From The Economist print edition

In the year to the third quarter, GDP rose by 5.6% in **Malaysia** and by 5.8% in **South Korea**. In October, **Singapore's** industrial production rose by 11.8% year-on-year, and consumer-price deflation eased. But in **the Philippines**, industrial production fell by 4.9% in the 12 months to September.

Argentina's stockmarket rose by over 10%, to its highest since February 2001.

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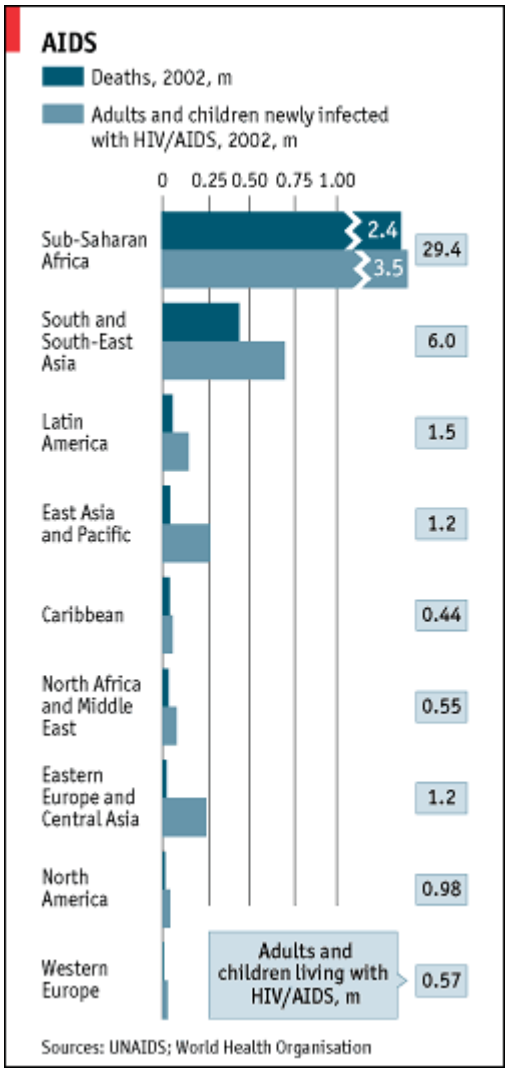
AIDS

Nov 28th 2002
From The Economist print edition

An estimated 3.1m people will have died of AIDS in 2002, according to new figures from UNAIDS and the World Health Organisation (WHO). Hardest-hit are the countries of sub-Saharan Africa, where 29.4m people live with the disease, roughly 70% of the global total.The epidemic is growing rapidly in Eastern Europe and Central Asia, where 250,000 people have been newly infected with HIV, and also in East Asia. Worldwide, some 5m people will have been newly infected in 2002. UNAIDS reckons that 29m new HIV infections could be averted by 2005 with the introduction of better prevention and more treatment in poor countries. Such initiatives would cost $10.5 billion by 2005, rising to $15 billion a year by 2007.



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Economy

Nov 28th 2002
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q3	+14.2	Oct	– 0.8	Oct	+30.0	Oct	+17.4	2001	258.6	Sep
Hong Kong	+ 0.5	Q2	–11.2	Q2	– 3.6	Oct	– 7.7	Oct	+15.7	Q2	110.6	Oct
India	+ 6.0	Q2	+ 6.1	Sep	+ 4.3	Sep	– 5.5	Sep	+ 2.0	Q2	60.7	Oct
Indonesia	+ 3.9	Q3	–11.7	Q1	+10.3	Oct	+26.6	Sep	+ 6.1	Q1	29.2	Sep
Malaysia	+ 5.6	Q3	+ 9.0	Sep	+ 2.1	Oct	+12.8	Sep	+ 6.9	Q2	33.9	Sep
Philippines	+ 3.8	Q3	– 4.9	Sep	+ 2.7	Oct	+ 2.6	Sep	+ 5.9	Aug	13.1	Oct
Singapore	+ 3.7	Q3	+11.8	Oct	– 0.2	Oct	+ 7.8	Oct	+18.9	Q3	81.4	Oct
South Korea	+ 5.8	Q3	+12.7	Oct	+ 2.8	Oct	+10.7	Oct	+ 5.2	Sep	116.3	Oct
Taiwan	+ 4.8	Q3	+ 7.4	Oct	– 1.7	Oct	+17.8	Oct	+25.0	Q3	157.6	Oct
Thailand	+ 5.1	Q2	+ 9.8	Sep	+ 1.4	Oct	+ 4.7	Oct	+ 6.9	Sep	36.8	Sep
Argentina	–13.6	Q2	– 3.4	Oct	+39.4	Oct	+14.9	Sep	+ 3.9	Q2	9.4	Sep
Brazil	+ 1.0	Q2	+ 5.6	Sep	+ 8.5	Oct	+11.2	Oct	–10.8	Oct	38.4	Sep
Chile	+ 1.8	Q3	+ 5.2	Sep	+ 3.0	Oct	+ 2.6	Oct	– 0.6	Q2	14.7	Sep
Colombia	+ 2.2	Q2	+ 1.0	Aug	+ 6.4	Oct	+ 0.5	Aug	– 1.3	Q2	10.6	Oct
Mexico	+ 1.8	Q3	– 0.6	Sep	+ 4.9	Oct	– 8.8	Oct	–16.3	Q2	46.6	Sep
Peru	+ 7.3	Sep	+ 7.6	Sep	+ 1.4	Oct	+ 0.3	Sep	– 1.0	Q2	9.4	Oct
Venezuela	– 5.5	Q3	– 6.6	Jul	+29.9	Oct	+ 8.5	Q2	+ 1.9	Q2	8.2	Sep
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 3.0	Sep	– 7.9	Jul	nil	Q2	13.0	Jun
Israel	– 0.8	Q3	– 0.2	Sep	+ 6.9	Oct	– 6.4	Oct	– 2.6	Q2	24.4	Oct
South Africa	+ 3.1	Q3	+ 8.6	Sep	+14.5	Oct	+ 3.1	Sep	– 0.3	Q2	5.9	Sep
Turkey	+ 8.2	Q2	+10.8	Sep	+33.4	Oct	–11.7	Sep	+ 1.1	Aug	25.6	Oct
Czech Republic	+ 2.5	Q2	+ 9.2	Sep	+ 0.6	Oct	– 3.0	Oct	– 2.3	Q2	22.5	Oct
Hungary	+ 3.1	Q2	+ 8.1	Sep	+ 4.9	Oct	– 2.9	Sep	– 2.7	Sep	10.1	Sep
Poland	+ 0.8	Q2	+ 3.2	Oct	+ 1.1	Oct	–10.3	Sep	– 6.6	Sep	28.2	Oct
Russia	+ 4.1	Q2	+ 3.9	Oct	+14.9	Oct	+42.9	Sep	+27.6	Q3	43.0	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 2.8	May	+ 3.5	Oct	– 1.2	Oct	+ 2.7	2002†	6.4	Sep
Saudi Arabia	+ 1.2	2001	na		– 1.1	Jul	+44.1	2001	+14.5	2001	17.8	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Nov 28th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 27th		Dec 31st 2001	
	Nov 27th	year ago	Nov 27th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.8	na	1,441.8	-3.2	- 15.8	- 15.8
Hong Kong	7.80	7.80	12.0	1.55	9,944.6	-0.3	- 12.7	- 12.8
India	48.2	48.0	74.5	5.39	3,174.1	+3.2	- 2.7	- 2.7
Indonesia	8,935	10,400	13,796	13.85	383.0	+3.1	- 2.3	+ 13.7
Malaysia	3.80	3.80	5.87	3.10	632.4	-0.7	- 9.1	- 9.1
Philippines	53.6	52.0	82.8	6.63	1,036.3	+0.2	- 11.3	- 14.6
Singapore	1.76	1.83	2.72	0.78	1,394.9	+0.8	- 14.1	- 10.0
South Korea	1,195	1,267	1,845	4.89	708.1	+3.8	+ 2.1	+ 12.2
Taiwan	34.7	34.4	53.6	1.95	4,633.0	-0.4	- 16.5	- 15.9
Thailand	43.4	44.1	67.0	1.91	361.4	+2.6	+ 18.9	+ 21.2
Argentina	3.48	1.00	5.37	8.60	509.6	+10.8	+ 72.5	- 50.4
Brazil	3.59	2.49	5.55	21.90	10,226.4	+1.4	- 24.7	- 51.6
Chile	707	676	1,092	2.76	4,789.3	-0.5	- 11.3	- 17.0
Colombia	2,755	2,311	4,253	7.93	1,439.5	-4.0	+ 34.4	+ 11.1
Mexico	10.16	9.27	15.7	7.24	6,129.3	+8.6	- 3.8	- 13.2
Peru	3.54	3.44	5.47	3.68	1,354.4	+4.8	+ 15.2	+ 12.0
Venezuela	1,320	746	2,038	29.91	7,873.8	+0.8	+ 19.8	- 31.2
Egypt	4.63	4.27	7.15	6.47	5,214.1	+2.8	- 1.1	- 2.3
Israel	4.64	4.23	7.16	6.40	357.9	+6.5	- 19.9	- 23.8
South Africa	9.3	9.87	14.3	13.55	9,367.8	-3.8	- 10.3	+ 16.3
Turkey	1,563,950	1,482,000	2,414,739	41.00	13,036.9	-1.9	- 5.4	- 12.0
Czech Republic	31.2	37.6	48.1	2.76	465.6	+3.8	+ 18.0	+ 34.6
Hungary	239	283	369	8.31	8,022.9	+5.3	+ 12.5	+ 29.3
Poland	3.99	4.06	6.16	6.63	14,850.6	+5.7	+ 6.7	+ 5.7
Russia	31.9	29.9	49.2	21.00	356.2‡	+1.4	+ 43.1	+ 37.0
EMF (MSCI)*	1.00	1.00	1.54	na	298.3	+2.4	na	- 6.0
EMBI+†	1.00	1.00	1.54	na	221.0	-0.5	na	+ 10.3

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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